

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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September of 2007: political and economic outcomes

As it has been expected, after the August standstill the month of September proved to be rather turbulent, not only as concerns the expected formation of the lists of candidates of the majority of Russian political parties. On September 13, M. Fradkov, the Prime Minister of the RF Government, had to resign together with the whole Cabinet. Similarly to the situation observed in February of 2004, there was chosen a rather bad pretext for this resignation. It was explained by the necessity to ensure stable work of the system of government in the pre-election period (it remained unclear what “instability” was noted in the activities of the Fradkov’s Cabinet). On the same day, Viktor Zubkov, the Head of the Federal Service for Finance Monitoring, was appointed as the new Prime Minister. Just in a few days his nomination was approved by the State Duma (only the group of KPRF and several independent deputies voted against him).

As it is well known, in December of 2007 there will be held the parliamentary elections, and in March of 2008 there should be elected the new President of the Russian Federation. In the situation of the specific Russian authoritarianism,¹ which does not envisage that the rulers of the country should take their offices for life, the key factor is the figure of the so called “successor”, i. e. the policy, in the framework of which anyone nominated by the incumbent head of the state should receive the support of the government at the elections and be announced as the next President of the country. It should be noted that in the course of such a policy, there are possible various technological combinations of this scheme depending on the pre-election position of the “successor” and the post-election office taken by the incumbent head of the state, the public or secret nature of arrangements between these two figures and so on. In spite of numerous statements that President Putin will, in some mysterious way, leave his office and at the same time somehow retain it, it is apparent that real power will be in the hands of the new President of Russia. Therefore, since the very moment the “successor” is nominated, power of V. Putin will begin dwindle at a very rapid rate. It seems that comparing himself with a sportsman, who “should play until the very last second of the game”, the President had in mind that nobody should know exactly whom he had chosen as his successor until the very last moment. Moreover, V. Putin stated that there were “at least five people who really have a chance to be elected the next President of Russia in March of 2008” and that after V. Zubkov had become the Prime Minister of Russia, it meant “that the people of Russia could choose from a larger group of candidates.”

Similarly to all important appointments and resignations of the past years, nothing was known about the appointment of V. Zubkov even immediately prior to the date of this appointment. In this connection there should be specially noted the defeat of the faction of V. Surkov, a deputy head of the Administration of the RF President, which has been carrying out an active PR campaign in favor of S. Ivanov, a First Vice Prime Minister (who was meant either to head the parliamentary election list of the United Russia political party, or to become the Prime Minister of the RF Government) since the summer of this year. Wishing to help V. Putin to make the right (from the point of view of V. Surkov) choice via the elite and media rallying around the figure of S. Ivanov, the Surkov’s staff did more harm than good to S. Ivanov. Indeed, one of few merits the former head of the RF Defense Ministry was thought to have, was the total absence of his own team and his personal loyalty to V. Putin. Having rallied a team of sponsors and fans around S. Ivanov, or just having made V. Putin to believe that such a team exists, these “helpers” stripped S. Ivanov of this advantage. Just a bit earlier, a scenario along the same lines was used in regard of D. Medvedev; as a result his chances have significantly diminished. Besides, V. Putin let foreign political analysts and the domestic elites know that “not I work for Surkov, it is he who works for me.”

It seems that it was not by chance that V. Zubkov indicated that he was ready to run for the office of the RF President² in the case his Government could demonstrate positive “results.” It will be V. Putin himself, who should decide if there are any “results,” what permits to arrive to the conclusion that from many possible scenarios the incumbent President has chosen the scenario of a weak rather than strong “successor.” A “successor” deprived of the adequate media support (and, therefore, promotion based on a high rating) and having to seek help of pure “administrative resource” at the same time having no “party of power” base, which will be able to take parliamentary seats by the time the “successor” is nominated should to a much

¹ However, this model is rather similar to some others – for instance, Mexico under the governance of the IRP, or contemporary Nigeria, where the former leader of the state O. Obasanjo after two successive tenures as the Nigerian President has reposed his power in the hands of his “successor” U. Yar’Adua, a former Governor, who, by the way, also was not included in the lists of possible “candidate successors” made by political analysts.

² Neither D. Medvedev, nor S. Ivanov, nor anybody else from V. Putin’s team has ever made public their Presidential ambitions.

greater extent depend on V. Putin. It should not be also excluded that several candidates for the office of the RF President will be nominated by Putin's faction, what will weaken the "successor" even further. By creating a polyarchic (or a pseudopolyarchic) environment, in which the "successor" should become the *primus inter pares*, the present master of the Kremlin is diminishing the risk that there emerge a scenario catastrophic for him, i. e. that the "strong successor," upon receiving the overall authority, will have the opportunity to dismiss all his obligations to V. Putin. It should be noted that in the medium term outlook there may also arise other risks (for instance, uncontrolled democratization or an attempt to return to Putin's model of governance on the part of the "successor").

However, there should be noted some indications that exactly V. Zubkov may be the final choice of V. Putin. Evidence of this is both his statements and the overall public style of an "unforgiving and resolute" Prime Minister being in a striking contrast with both V. Zubkov's usual manner prior to his appointment and with his predecessor. There may be also recalled the advanced age of V. Zubkov, what can offer someone hope for the "temporality" and transient nature of this figure.³ However, a good advice would be not to concentrate on such ideas – V. Zubkov may not like them.

The economic and political views of the new Prime Minister remain practically a mystery and most probably he either has no independent views at all or those practically identical to the concepts prevailing in the existing reality. From our point of view, it would be wrong to arrive at concrete conclusions on the issue basing only on a very few statements made by V. Zubkov over a short period he participated in the elections as a candidate for the office of the Governor of the Leningrad oblast very long ago, in 1999. However, there should be noted the professional abilities of the new Prime Minister – in 2004 his statements that the RF Government had a "list" of unreliable banks provoked the development of an acute phase of the banking crisis; as a result, after the crises there were less banks and less customers' money.

Viktor Zubkov worked with Vladimir Putin in the Committee on external relations of the St. Petersburg Mayor's Office, later he headed the regional office of the tax inspection, in 1999 through 2001 he was a Deputy Minister of the RF Tax Ministry and in 2001 he became the head of the Committee on Financial Monitoring (this agency was renamed as the Federal Service for Finance Monitoring in 2004). The fact that V. Zubkov is the father in law of A. Serdyukov, the RF Defense Minister received broad publicity. Serdyukov even attempted to resign because of this circumstance; however, his resignation was not accepted, moreover, yet another married couple appeared in the RF Government as the wife of V. Khristenko was appointed as a Minister. Although relatives can sometimes be found in foreign governments (for instance, in the UK at present two brothers serve as Ministers), in the top echelon of the leadership of the Russian Federation the number of relatives working together is more reminiscent of eastern rather than western regimes.

The new personal composition of the RF Government implies a practical lack of surprises in the sphere of economic policy. Thus, the status of A. Kudrin, associated by the market with a responsible fiscal policy of the last years, and who retained also his previous office and, was raised to a Vice Prime Minister. One of his subordinates – T. Golikova – was appointed as the new Minister of Health Care and Social Development; she replaced in this office M. Zurabov, the most unpopular Minister of the previous Cabinet, who could damage both the rating of the "party of power" and the "successor" before the parliamentary elections in the case he retained his post in the RF Government. In stead of G. Gref E. Nabiullina, who had been G. Gref's first deputy until 2003 and later being one of the experts in a think tank close to the Gref's Ministry, was made the new head of the RF Ministry of Economic Development and Trade. Although it remains unclear if G. Gref's resignation was voluntary, it should be noted that the new Minister succeeds G. Gref in terms of ideology he promoted and has no known principally different opinions (although the political weight of the new Minister will be much less than that of G. Gref). As concerns the future of the resigned Ministers, it seems apparent that they will find some jobs in the spheres under the direct influence of the state (in some governmental agencies or state owned companies).

As concerns the new appointments of Ministers, the most important development in the new RF Government is the end of the Caucasus exile of one of the most influential officials of V. Putin's first tenure in office – D. Kozak. Mr. Kozak was appointed as the new Minister of Regional Development replacing V. Yakovlev. At the same time, in the course of more precise determination of the Ministry's functions it was made responsible for the issues of management of the RF investment fund (earlier, this responsibility was

³ The Kremlin propagandists have for a long time suggested that V. Putin has the opportunity to return to his present office in four years or "even earlier." However, it seems that such a scenario is practically impossible. It should be noted that earlier the propagandists believed such a scenario could develop basing on the figure of M. Fradkov by presenting similar considerations on his age, state of health and so on.

with the RF Ministry of Economic Development and Trade). It should be noted that the amount of the said fund for the current year makes more than Rub. 170 billion of investments from the RF budget. This development means that D. Kozak obtains not only enormous financial resources, but also a very significant political resource, since the fund has the powers to co-finance (or refrain from co-financing) projects carried out by large businesses. It is highly probable that D. Kozak will be also made responsible for the issues relating to the implementation of targeted development programs for regions and the issues related to the sphere of housing and public utilities. It seems that no serious ideological novellas should be expected on the part of D. Kozak. As yet, no candidate for the vacancy left by D. Kozak in the North Caucasus, where the situation in the Chechen Republic, the Republic of Ingushetia and Dagestan seriously aggravated over the last year,⁴ has been nominated. There have been made no other personal changes at the level of the RF Government.

In September, there resigned from his office a person whose weight exceeded that of many Ministers – S. Vainshtok, who had managed the Transneft company, the transport state owned monopoly, since the autumn of 1999. Although initially he was seen as a representative of two clans (Sibneft and Lukoil), as it had turned out S. Vainshtok could take a position above private interests and become somewhat like the “president of all oil related businesses.” Under S. Vainshtok, there were rapidly created nontransparent but clear for the oil industry rules of the game, whereas the transport capabilities of Transneft were increase in the interests of the whole industry. Depending on the personal composition of the new management of the company, it will become clear if the course towards “relatively fair” regulation of the oil pipelines is maintained.

In September, there were held pre-election congresses of major political parties with the exception of the United Russia. The most interesting situation has arisen in regard of the party lists of A Just Russia, a political project positioned as a left force and headed by S. Mironov, the long time close associate of V. Putin. The project has started rather well at the regional elections; the party could obtain guarantees that it would be allowed to participate in the elections and even begin to seek the status of an alternative “party of power.” In one region (the Stavropol krai) it could even defeat the United Russia political party in the course of the elections held on the basis of party lists and in another region (the Republic of Tuva) it was able to receive the aggregate majority in the regional parliament and make to resign the former head of this Republic. The major successes of this project resulted from the fact that regional actors having available their own electoral and financial resources joined A Just Russia party, since they needed to be on the list of a party, which would not be removed from the electoral process. Besides, an important circumstance was that this project had no such a negative rating as KPRF, LDPR or “democrats.” However, yet the spring round of elections demonstrated a number of serious problems A Just Russia political party faced, for instance, in a whole number of regions due to various reasons the party failed to find any serious regional partners, whereas its low federal rating bore a high risk that it would not be able to clear the barrier for entry to the State Duma at all.

In the spring and summer of 2007, the authorities carried out a number of special operations at the federal and regional levels aimed to prevent the inclusion of famous public figures in the party lists of A Just Russia (from S. Glazyev to Ye. Roizman, a State Duma deputy and a popular fighter against the drug mafia). In fact, in September there became evident the real threat of the political suicide A Just Russia could commit under the Kremlin pressure in favor of the United Russia political party. As a result, A Just Russia suffered only two, although important, losses as concerned its regional party lists: it had to remove A. Lebedev, a famous adversary of the Moscow Mayor from its City of Moscow list and mentioned above Ye. Roizman from its Sverdlovsk list. Almost all well known regional politicians could retain their positions on the party lists. Besides, it should be mentioned that A Just Russia could form a rather attractive top three of its federal list – alongside S. Mironov it consists of notorious S. Goryacheva and S. Shargunov, a charismatic former leader of the youth organization of the Rodina political party. It seems that all these developments can help A Just Russia to struggle against the Communists for the second position in the State Duma, moreover, taking into account the fact that A Just Russia has an advantage over the KPRF in terms of available financial resources.

The Communists put their stakes on their traditional electorate, the “Soviet patriots”: the federal top three list of the KPRF includes G. Zyuganov, Zh. Alferov, and academician and a Nobel Prize winner, and N. Kharitonov, an “agrarian” and a former Presidential candidate from the KPRF. However, it should be noted that at this time on the home stretch of the election campaign the Communists are in a rather difficult situation: on one hand, the rating of the party is relatively good and the KPRF seems to be able to take the second place in the State Duma race, but on the other hand the Communists have modest financial resources and are

⁴ It should be noted that we do not blame D. Kozak exclusively for these negative developments.

weakened by the internal party struggle – on the eve of the parliamentary elections G. Zyuganov and his fraction started a purge of supporters of the radical opposition and their personal enemies accusing them of being adherents of “Neo-Trotskyism” – a topic not interesting for left voters.

At the same time, LDPR is attempting to mobilize its usual eclectic and jingoistic electorate having placed A. Lugovoi, a secret police agent accused of the murder of A. Litvinenko, as the second, after V. Zhirinovski himself, member of the party federal top three list. In the situation, where the authorities could in fact intercept the political program promoted by LDPR (authoritarianism, appointment of Governors, anti-West rhetoric and so on), it is hard to tell if this policy of LDPR is successful. However, taking into account the traditional advertising of V. Zhirinovski on the state owned TV channels it may be suggested that this branch of the “party of power” will be able to take some seats in the Parliament of Russia.

As concerns other political parties permitted to take part in the elections, only SPS (the Union of Right Forces) has a hypothetical chance to clear the barrier for the entry to the RF State Duma, taking into account the fact that this party has available a rather significant financial resources and sound regional organizations. However, similarly to the KPRF situation, the party is far from being united with respect to both problems of personal composition and principal issues, whereas its federal top three list consisting of N. Belykh, B. Nemtsov and M. Chudakova can attract the base electorate, but hardly any new supporters. Taking into account the recent comments by V. Putin on the financing of the SPS it should not be excluded that the funding of the promotional network of the party may dwindle, what can result in serious losses for this organization.

S. Zhavoronkov

Budgetary and Tax Policy

According to the tentative performance of the budget in January-August 2007, the level of revenue of the RF federal budget made 23.2 per cent of GDP; the expenditures of the federal budget accounted to 15.8 per cent of GDP, budget surplus has come up to 7.4 per cent of GDP. On September 2007, the RF Stabilization Fund made RUR 3.409.1 billion, as compared with RUR 3 263.6 on August 2007, which makes 11.7 per cent and 11.5 per cent of GDP per annum.

The State of the Federal Budget

The dynamics of basic parameters of the RF federal budget within 2005-2007 are presented in Table 1. According to the tentative estimates of the federal budget execution on cash basis, made by the RF Ministry of Finance, the federal budget was executed in terms of revenues in the amount of RUR 4 510.35 billion (23.19 per cent of GDP) and in the amount of RUR 3 067.63 billion in terms of expenditures (15.77 per cent of GDP). The budget surplus accounted to 1 442.7 billion (7.42 per cent of GDP). The amount of revenues and expenditures of the federal budget within the period under review in absolute terms was higher than the respective indicators of preceding year (revenues RUR 4 022.4 billion, expenditures RUR 2 555.0 billion). Some decline was registered in the federal budget revenues in GDP share (24.31 per cent of GDP в 2006), while expenditures have exceeded the level of preceding year (15.44 per cent of GDP in 2006). The indicator of federal budget surplus in nominal terms is close to the level of preceding year (RUR 1 467.3 billion), whereas in GDP share a decline is observed versus the relevant period of preceding year (8.87 per cent of GDP).

Table 1.

Basic Parameters of the RF Federal Budget (per cent of GDP)

	2005	August 06	2006	August 07
Revenues	23,7%	24,3%	23,5%	23,2%
Expenditures	16,2%	15,4%	16,2%	15,8%
Deficit (-)/ Surplus (+)	7,5%	8,9%	7,4%	7,4%

Source: RF Ministry of Finance, IET estimates.

For the structure of federal budget revenues over the period under observation in terms of budget execution by federal agencies, see Table 2.

Table 2.

**Amounts of Revenues to the RF Federal Budget in 2005-2007
(per cent of GDP in terms of cash basis execution)**

	2005	August 06	2006	August 07
Taxes and other payments administered by the Federal Tax Service	12,33%	12,03%	11,27%	11,64%
Taxes and other payments administered by the Federal Customs Service	9,73%	10,92%	10,76%	10,12%
Receipts administered by the Federal Agency for Management of Federal Property	0,27%	0,22%	0,26%	0,20%
Revenues of the federal budget administered by other federal structures	1,35%	1,15%	1,25%	1,23%
Total revenues	23,67%	24,31%	23,54%	23,19%

Source: RF Ministry of Finance, IET estimates.

As one can see in the Table, in January-August of 2007 the structure of tax revenues and other proceeds in terms of GDP share as broken by individual sections has decreased in comparison with the data, registered in the relevant period of preceding year. The utmost decline was observed in taxes and other proceeds, administered by the RF Federal Customs Service, their share in GDP made 0.80 per cent. Taxes and other proceeds administered by the RF Federal Tax Service decreased by 0.38 per cent of GDP. The amount of revenues, administered by the Federal Agency for Property Management went down by 0.02 per cent of GDP. As opposed to that, revenues of the federal budget, administered by other federal bodies, have demonstrated some upgrading in January-August of 2007 (by 0.09 per cent of GDP).

The general trend to budget revenues downgrading as compared with the relevant period of 2006, is basically explained by accelerated GDP growth. As mentioned in previous surveys, the GDP growth acceleration is based on three factors. First, abnormally warm winter allowed to continue construction works. Second, investors and consumers activity has grown at the beginning of 2007. Third, significant contribution was made by the "base effect" (at the beginning of 2006 GDP growth rate was rather slow). Another factor, hindering the growth rates of federal budget proceeds against growth rates of Russian economy in general, is lowered oil price (as compared with the first six months of 2007 (see Table 3).

Table 3.

Oil Prices within January-August 2006-2007

Average prices for Urals oil, USD per barrel ⁵	2006	2007
January	59,18	49,79
February	56,37	53,73
March	57,53	58,69
April	65,17	63,88
May	64,33	64,09
June	63,85	68,05
July	68,93	74,37
August	68,64	68,82

As of January-June 2007 results, proceeds from mineral extraction tax and export customs duties made 39.4 of consolidated federal budget revenue. The relevant indicator of the similar period of 2007 amounted to 48.6 per cent. This demonstrates some reduced dependence of federal budget revenues on proceeds from mineral extraction sector, though explicit impact of those proceeds over the dynamics of budget revenues is still observed.

Estimates of the RF Ministry of Finance on the RF federal budget expenditures in January-August 2007 are presented in Table 4.

⁵ Prices used for the purpose of taxation.

Table 4.

Amounts of Financing of the RF Federal Budget Expenditures in 2005-2007(% of GDP)

	2005	August 06	2006	August 07
Federal issues	2,58%	2,56%	2,19%	2,36%
Including expenditures associated with the servicing of federal and municipal debt	1,06%	0,90%	0,65%	0,57%
National defense	2,71%	2,89%	2,57%	3,14%
National security and law enforcement	2,05%	2,31%	2,08%	2,44%
National Economy	1,17%	1,26%	1,31%	1,54%
Housing and public utilities	0,04%	0,23%	0,20%	0,23%
Environmental protection	0,02%	0,03%	0,03%	0,03%
Education	0,73%	0,83%	0,78%	1,04%
Culture, cinematography and mass media	0,22%	0,23%	0,21%	0,24%
Health care and sports	0,42%	0,64%	0,56%	0,73%
Social policy	0,88%	0,97%	0,81%	0,86%
Interbudgetary transfers	5,77%	6,58%	5,68%	6,97%
Total expenditures	16,58%	18,55%	16,40%	19,58%

Source: RF Ministry of Finance, IET estimates.

Comparison of expenditures broken down by budget lines for the period of January-August 2007 demonstrates, that the utmost downfall (in GDP share) was observed in the following areas: expenditures for Federal issues (-0.20 per cent) and Social policy (-0.11 per cent). Those lines amounted to 16.5 per cent of the total volume of financed expenditures of the federal budget for January-August 2007. An explicit growth in GDP share versus the relevant period of preceding year was registered in Interbudgetary transfers (+0.39 per cent of GDP). Certain upgrading was registered also about expenditures for National economy (+0.27 per cent of GDP), National defense (+0.24 per cent of GDP), Education (+0.20 per cent of GDP), National security (+0.13 per cent of GDP) and Health care and sports (+0.09 per cent of GDP). Expenditures under those budget lines have accounted to 81 per cent of the total federal budget expenditures. Differences in execution of other budget lines were not so noticeable (lower than 0.01 per cent of GDP).

It is worth mentioning, that there was no opportunity to analyze the dynamics of federal budget expenditures and revenues for January-August in the current month, as relevant reports of the RF Treasury (used by other authors in earlier surveys) were not published yet at the moment of the present survey preparation.

As of September 2007, the volume of the RF Stabilization Fund made RUR 3.409.1 billion, as compared with RUR 3 263.6 on August 1, 2007, which makes accordingly 11.7 per cent and 11.5 per cent of GDP per annum.

Major developments in the budgetary sphere.

Last month a new person was appointed to the position of the Russian Prime Minister and some changes were made in the government staffing as well. Mr. Victor Zubkov became the new Prime Minister. In the process of HR restructuring, Aleksey Kudrin was promoted and took the position of the Minister of Finance in line with Deputy Chairman of the Government. According to his words, this appointment demonstrates consistency of the effective economic policy, as well as higher responsibility for the results thereof.

Aleksey Kudrin has informed, that ministries and other government agencies will upgrade the volume of financing for all types of works and services from about RUR 450 billion in October up to nearly 1 trillion in December. In his opinion, this measure will permit to solve the problem of ruble liquidity. Nevertheless, Mr. Kudrin admitted, that such growth of budget expenditures is the consequence of inconsistent budget execution on the part of civil servants. Moreover, the RF Ministry of Finance will implement measures of more strict control over the time frames of VAT refund to the Russian companies by the Federal Tax Service (FTS), which will also contribute to improve liquidity in the Russian financial market. Moreover, according to the Head of the Ministry of Finance, uncommitted funds of development institutions (such as Bank of Restructuring and Development) will be allocated in the national market.

At the VI-th International Investments Forum, held in Sochi, Mr. Aleksey Kudrin has made one more statement. According to his words, by 2011 the share of oil and gas revenues in the total volume of government investments financing will be reduced. In the opinion of the Head of the Ministry of Finance, excessive exploration of oil and gas resources in preceding years resulted in the high rates of ruble strengthening and accelerated inflation.

O. Kirillov

Budgetary and Tax Policy

In August the consumer price index was lower than in the relevant period of preceding year: average consumer prices grew by 0.1 per cent country-wide. However, rapid growth of foodstuffs prices (due to the upsurge of price for grain), as well as a significant monetary expansion in the first six years of the year, left little chance for that trend sustainability in the autumn months. In August, the RF financial market was influenced by the global liquidity crisis, in response to which the RF Central Bank has expanded direct REPO operations. Due to the outflow of capital from the country, the volume of gold and foreign currency reserves remained unchanged in August. However, in September the situation got stabilized, and within three weeks of the month foreign currency reserves in the RF have been increased by 1.6 per cent.

The CPI value in August made 0.1 per cent, as compared with 0.8 per cent in August 2006 (see Fig.1). As opposed to the situation of preceding three months, an explicit impact over consumer price growth in August was provided by higher prices for non-food products. Those prices have grown on average by 0.6 per cent country-wide (+ 0.8 per cent in July 2006). The growth of non-food products prices has provoked an upsurge in prices for construction materials (+ 2.7 per cent), petrol (+ 1.3 per cent), as well as sanitation and cleaning materials (+ 0.7 per cent). It is worth mentioning, that in August a new downgrading of audio-video products was registered in the amount of 0.2 per cent.

Upgrading of commercial public services in August reached 0.5 per cent (+ 0.8 per cent in August of 2006). The utmost growth was observed in regard to education (+1.5 per cent) in view of the forthcoming school year.). Besides, significant growth was observed in the peak season for services of international travel agencies (+ 1.3 per cent) and in regard to health-care and resort services (+ 0.7 per cent). There was no decrease in any type of services observed in August.

In August, prices for food stuffs went down by 0.6 per cent due to the downgraded prices for vegetable and fruit products by 16.1 per cent. However, other than vegetables and fruit food stuffs prices have raised by 1.6 per cent. The utmost growth of prices was observed about granulated sugar (+ 7 per cent), bread and bakery products (+ 5.2per cent), pasta (+ 4.3per cent), cereals and beans (+ 2.9 per cent), butter (+ 3.1 per cent), milk and dairy products (+ 1.9 per cent). Apparently, the basic factor of accelerated growth of prices in August was the upsurge of grain prices in the RF market. In case of further growth, the RF government will take intervention measures in the grain market in order to achieve stabilization of prices.

The basic consumer price index growth⁶ in August made 1.1 per cent (versus the level of 0.6 per cent the relevant period of preceding year), which is the peak value, reached since 2006.

In our view, this fact is quite natural consequence of rapid monetary expansion in the current year: within January-July 2007 the monetary base in broad definition grew by 19.3 per cent, whereas in the same period of 2006, that growth made 13.4 per cent. At the same time, in June-August a decrease in the monetary base in broad definition was observed, what provides grounds to reduction of inflation pressure in future. According to the bulletin of approximation short-term estimates of the RF socio-economic indicators, published by IET, the CPI in September 2007 made 0.5 per cent.

⁶ Basic index of consumer prices is an indicator of the inflation level without regard to seasonal price reduction (fruit and vegetable products) and to administrative measures (tariffs for government-regulated services, etc.). It is estimated by the RF Statistics Service

The Growth Rate of the CPI in 2002 - 2006 (% per month).

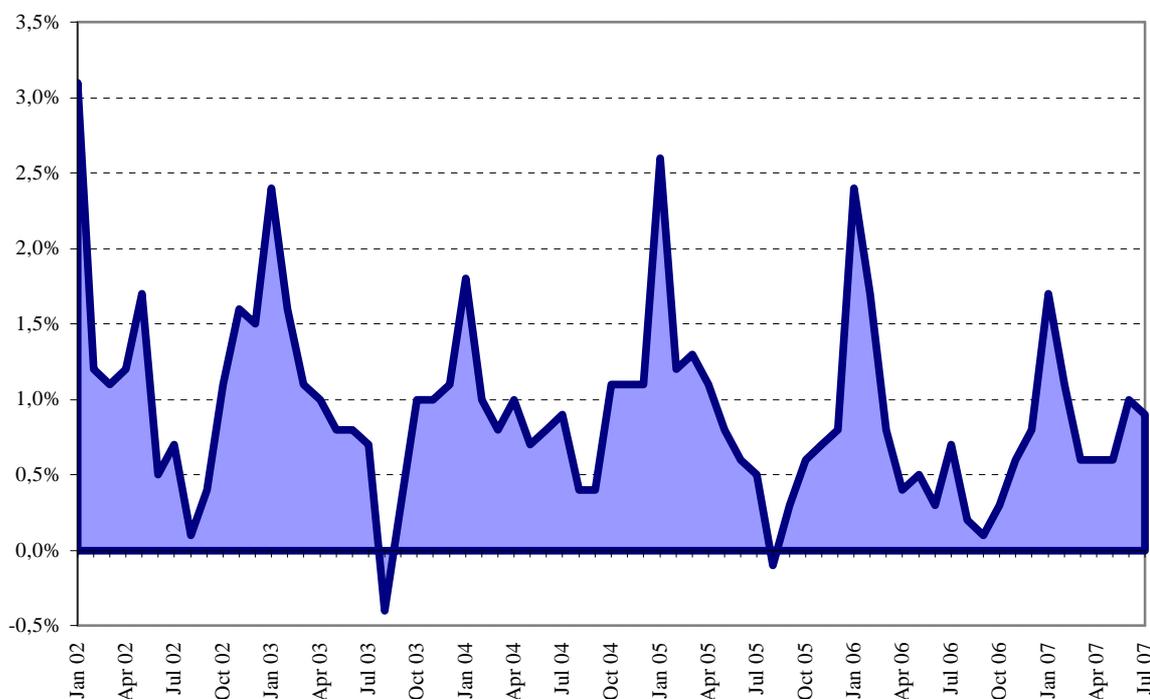


Fig. 1

Source: RF Statistical Service.

Within August 2007 the volume of cash in circulation (in broad definition⁷) has been decreased by RUR 162.6 bln, to the level of RUR 4758 (- 3.3 per cent). The volume of monetary base in broad definition as of August 1, 2007 was RUR 4920 bln. Let us consider the dynamics of monetary base in broad definition by components.

The cash in circulation volume, including the cash balances of credit institutions, as of September 1, 2007 was RUR 3.41 trillion (+ 2.8 per cent as compared with August 1), the correspondent accounts of credit institutions with the Bank of Russia made RUR 452.4 bln (-6 per cent), mandatory reserves – RUR 311 bln (+ 2.1 per cent), credit organizations’ deposits with the Bank of Russia – RUR 205.7 bln (- 51.9 per cent), the value of the Bank of Russia bonds held by credit institutions – RUR 375.7 bln (+ 0.4 per cent).

The reduction in reserves of commercial banks in August was the result of global liquidity crisis. To mitigate its impact on the Russian banking system, the Bank of Russia has undertaken decisive measures to provide the required volume of liquidity to the banks. The basic measures for banks refinancing were REPO operations: on August 28 their daily volume exceeded RUR 270 billion, which is the maximum indicator since the beginning of 2002.⁸ As one can observe from Fig. 2, the volume of those operations has rapidly decreased, what demonstrates somewhat reduced tension in the Russian financial market.

The growth of cash in circulation in August of the current year (by 2.8 per cent) at the background of reduced mandatory reserves (by 2.1 per cent) has resulted in extension of the monetary base in narrow definition (cash + mandatory reserves)⁹ by 1.4 per cent (see Fig.3). Herewith, the gold and foreign currency re-

⁷ The RF monetary base in broad terms with no regard to the cash issued by the Bank of Russia and the balance of Compulsory Reserve Accounts on credit organizations in national currency, deposited in the Bank of Russia, taking into account the assets of correspondent accounts and bank deposits, allocated in the Bank of Russia..

⁸ Earlier data is not available.

⁹ Monetary base in a narrow definition is a monetary instrument (an indicator of monetary supply volume), which is fully controlled by the RF Central Bank. The Monetary base in narrow definition includes the cash in circulation, issued by the Bank of Russia (and the balance on the accounts of credit organizations), balances on the accounts of mandatory reserves of the funds in the national currency attracted by credit institutions in national currency, deposited with the Bank of Russia.

services of the RF Central Bank also have been sustained and amounted, as of September 1, to USD 416 bln. Within the first two weeks of September they have increased by 1.6 per cent and reached the level of USD 422.5 bln. A greater portion of the national liquidity inflow was accumulated in the RF Stabilization Fund, which volume as of September 1, 2007 has amounted to RUR 3409.1 bln. (+ RUR 145.5 bln against August 1 of 2006). The volume of the RF Stabilization Fund has reduced by RUR 475.4 bln within the relevant period of preceding year.

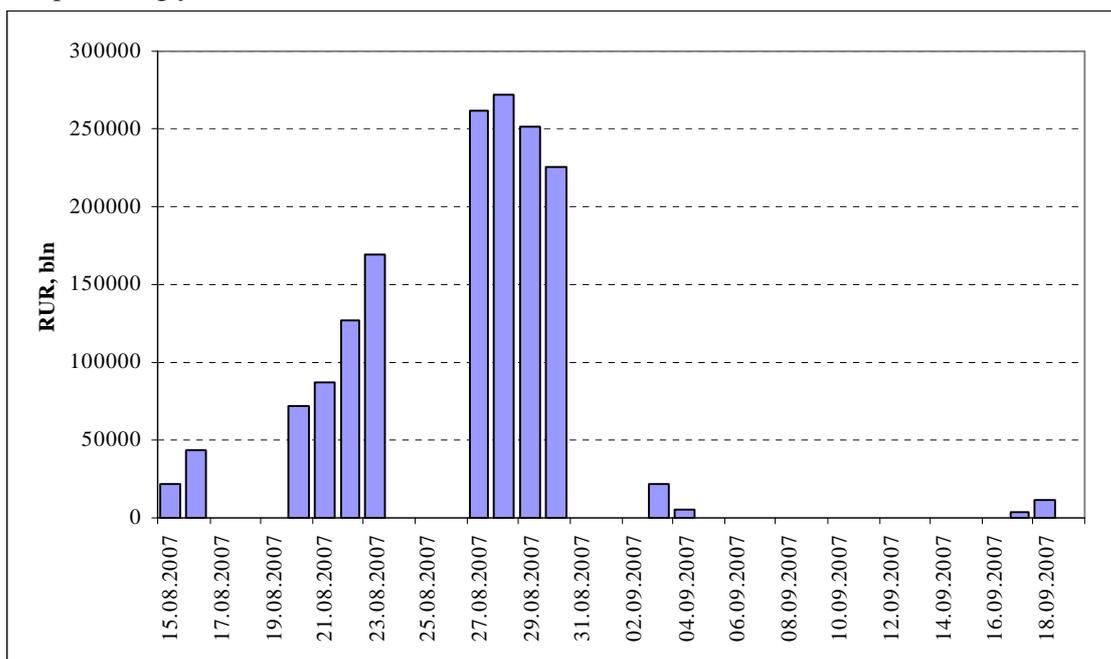


Fig. 2. The volume of daily direct REPO, performed by the RF Central Bank in August-September 2007.

Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2005 - 2006.

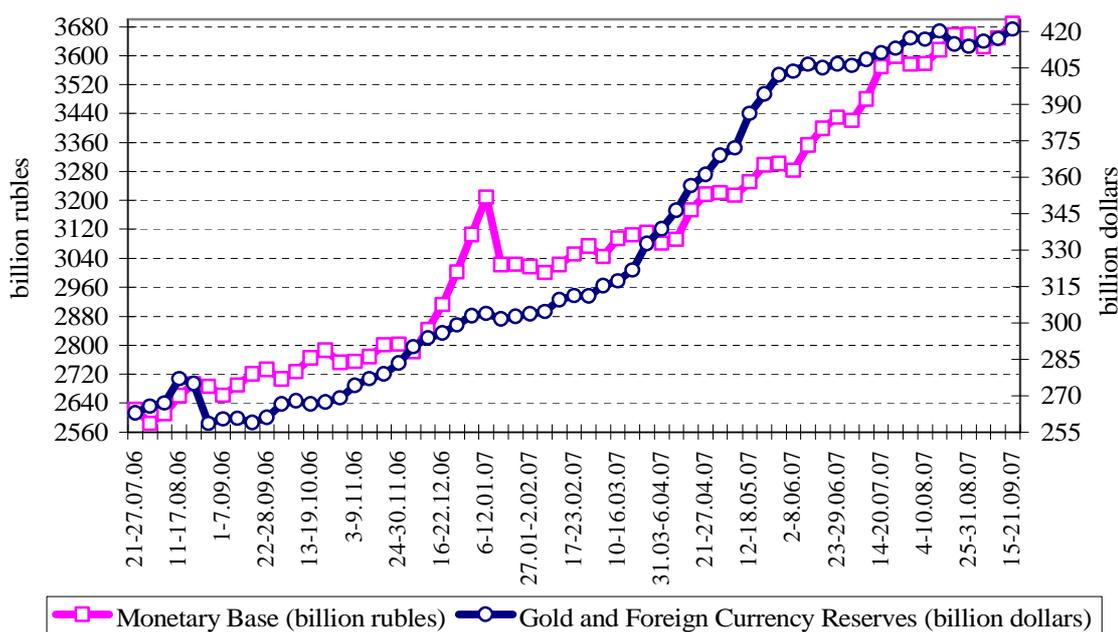


Fig. 3.

Source: RF Central Bank.

According to the information of the Federal Treasury, in June 2007 USD 151.8 million was spent to cover the debt of Russia. USD 45.1 million was spent for redemption of the debt, while USD 15 million was paid for the services thereof. USD 21.8 million was addressed to cover the debt of Russia, USD 89.5 for the USSR debt, USD 40.5 million for the World Bank and EBRD loans, USD 0.04 million for loans raised upon bonds.

P. Trunin

Financial Markets¹⁰

In July the situation in the Russian financial market was relatively favorable. While the debt markets were explicitly influenced by global crisis in monetary market liquidity and uncertainty about the impact of the US mortgage crisis on the growth rates of the world economic leader, stock markets demonstrated rather steady growth.

In the middle of the month the US IRS has reduced the interest rate on federal funds by 0.5 p.p, i.e. to 4.85 per cent per annum, what has supported the debt market and inspired steady growth of the world stock markets.

Government securities market

In September, a convergence of traded issues yields, accompanied with an insignificant trend to downgrading thereof, was observed in the market of the Russian government bonds, denominated in foreign currency.

Dynamics of the debt markets for almost the entire month was highly dependent on the news from USA. Early in the month the bulk of published macroeconomic statistics (especially in regard to the labor market) was worse than analysts' expectations, which reflected investors' concern about the impact of the mortgage and housing crisis on the real sector and strengthened their confidence that the US IRS will reduce the interest rate at least by 0.25 p.p. on September 18. In the background of those expectations, the yields of the US government bonds have declined in general, what was a positive factor to the Russian Eurobonds. Nevertheless, no substantial increase in quotations was observed, as in the situation of downgrading liquidity the investors were prudent to open long positions. At the meeting, held on September 18, the US IRS adopted the decision to reduce the interest rate by 0.5 p.p. at a time, to the level of 4.75 % per annum, what was positively accepted by investors in the debt market and induced some upsurge in demand for the bonds, including those ones of developing countries, Russia among them. The yields of traded securities have further declined, though insignificantly. Despite the interest rate reduction, exceeding the expectations, there was no significant improvement of the situation with liquidity in the world market. Moreover, one of the largest mortgage banks in UK, Northern Rock declared substantial losses and appealed for assistance to the monetary authorities of England. In the situation of sustained uncertainty, the demand for debt instruments was restrained.

As of September 28, the Russian Eurobonds' RUS 30 yield to maturity made 5.79 per cent per annum, RUS-18 – 5.89 per cent per annum. As of the same date, the yield to redemption of the Russian Eurobonds made: for the eight tranche of external currency debt bonds – 2.86 per cent, seventh tranche bonds – 5.56 per cent, fifth tranche bonds – 5.66 per cent.

The situation in the Russian ruble debt market was far from favorable. At the beginning of the month, the pressure of external factors, coupled with a significant deterioration in the domestic liquidity hindered activity of the investors in the market. Moreover, in order to secure the necessary level of liquidity, Russian banks were also tended to sell securities, what provided additional pressure over the market. Closer to the middle of the month market activity was pending in expectation of IRS decision on the interest rate.

Immediately after the IRS decision, adopted on September 18, the market activity has revived, growth in demand was registered in the market, but it did not last long and in a few days some of the bonds have somewhat declined in the background of general market correction. However, by the end of the second decade of the month a strong demand in OFZ market was recorded for government bonds with long positions, which has led to significant price growth. According to analysts, the demand was initiated by government or pro-government structures for the purpose of support liquidity in the banking sector, since shortly before that

¹⁰ In the course of preparation of the survey, there were used analytical materials and surveys published by the Zenith Bank, investment company ATON, MICEX, and the materials presented at web sites of Russian issuing companies.

event, statements of the Minister of Finance were published on government commitment to support the banking sector.

FIG. 1.

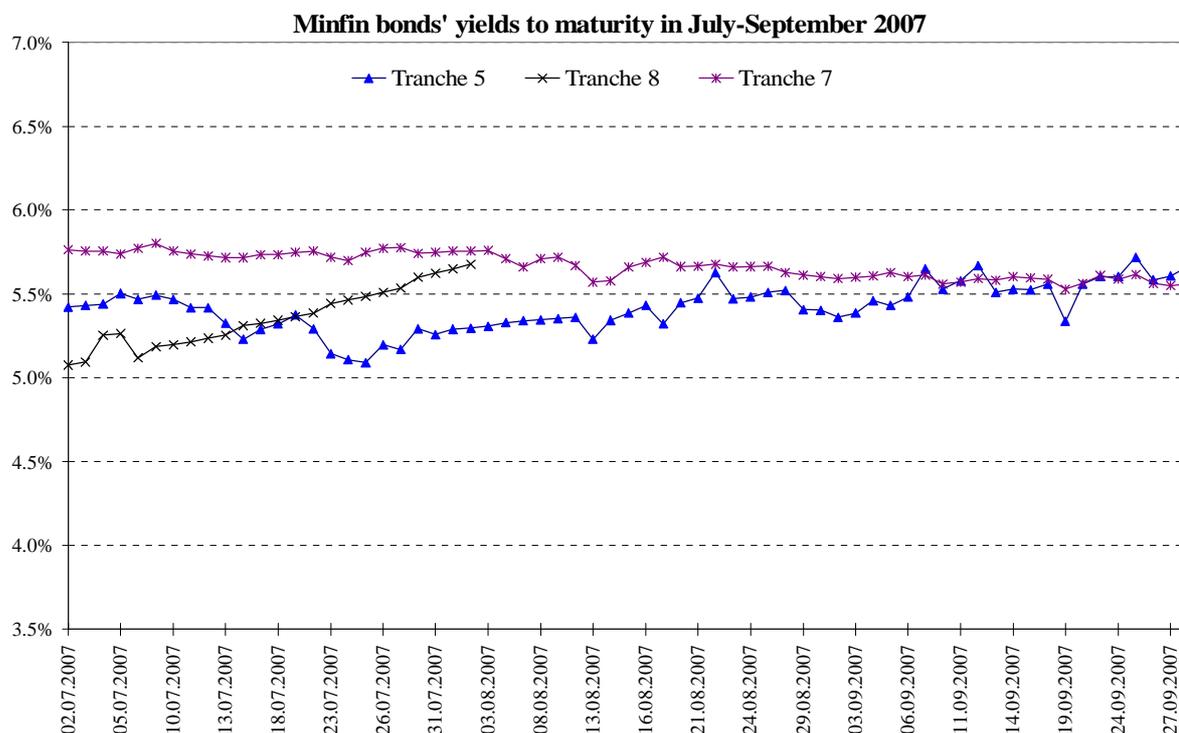
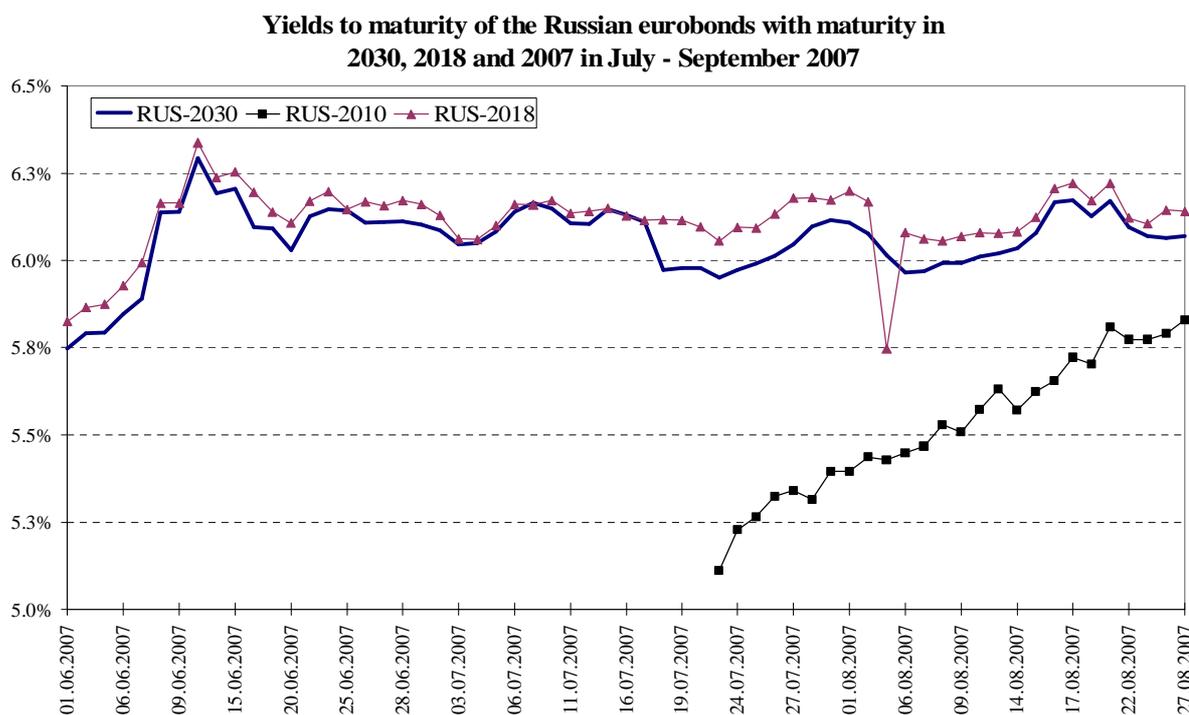


FIG. 2.



Within the period from September 3 to 28 the total turnover of GKO- OFZ secondary market amounted to approximately RUR 137.9 billion with an average daily turnover of RUR 6.9 billion. (about RUR 86.81 billion with an average daily turnover of RUR 4.57 billion in August). Two auctions on additional OFZ placements were arranged within the month. Thus, the auctions were held on September 12 on placements of OFZ series 46018 and 46020 for the amount of RUR 17 and 22 billion accordingly. Actual placement volume made RUR 13.1 and 15.1 billion accordingly with average weighted yields of 6.88 and 7.06% per annum respectively.

As of September 28, the GKO-OFZ market amounted to RUR 1031.8 bln at face value and to RUR 1034.67 bln at market value. The duration of the GKO-OFZ market portfolio was 2152.28 days.

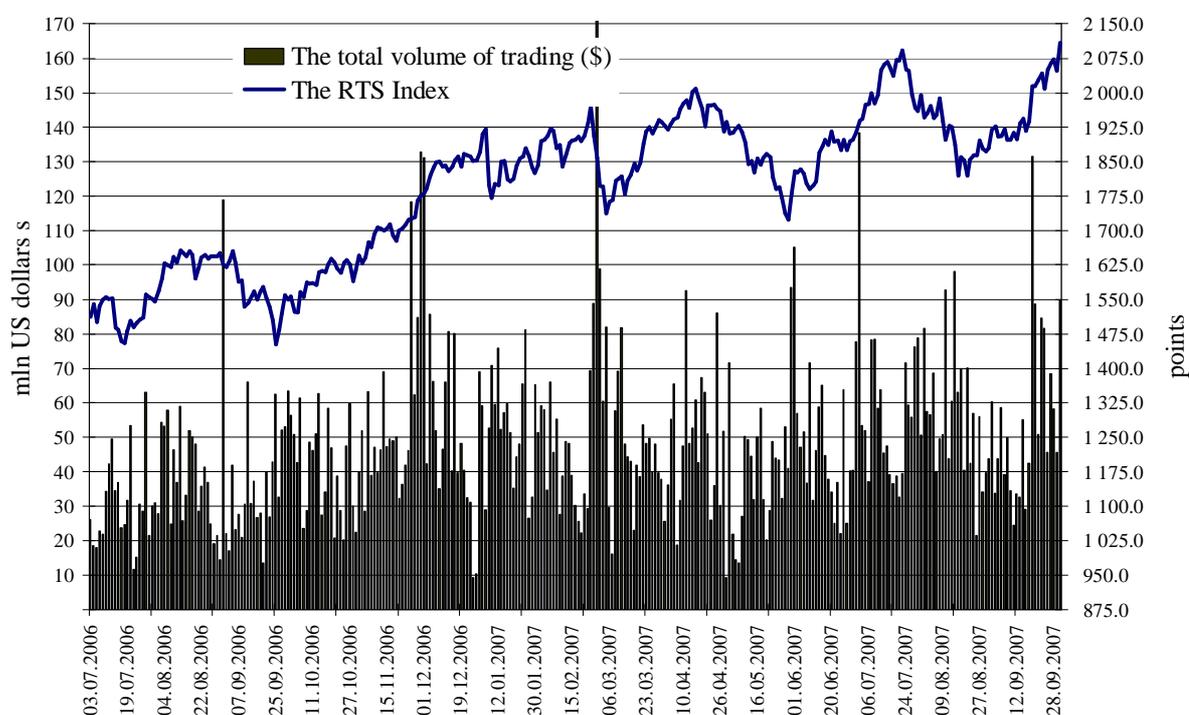
Equity Market

Stock market situation

Despite global financial instability and a significant deterioration of the situation with ruble liquidity in the domestic banking sector, the Russian stock market has explicitly grown as of September results. By the end of September the RTS index has closely approached the historical maximum, reached in July. Obviously, the main factors of domestic bonds growth in September were the lowered interest rate in the United States, historic maximums of oil prices and some positive corporate news. Despite the fact that during the first half of the month the activity of the investors in the stock market was fairly low and consolidated index was around 1900 points, the bonds have noticeably grown after the IRS decision.

This trend for prices growth sustained till the end of the month. Restructuring in the Cabinet of Ministers in the first half of the month and prompt appointment of Mr. V. Zubkov (former Head of “Rosfinmonitoring”) to the position of the Prime Minister, provided virtually no impact on the stock market. Although organizational changes in the structure of the Cabinet of Ministers were minor, the appointment of Ms. E. Nabiullina, who is regarded by many experts as a liberal economist, to the position of the Minister of Economy, could provide additional support to the stock market. The fact that Mr. Kudrin kept his position of the Minister of Finance is also favorable to the economy in general and to the financial markets in particular, as it will make for stability in public finance sector in future, what is positive in terms of global attractiveness of the Russian stock market.

FIG. 3.

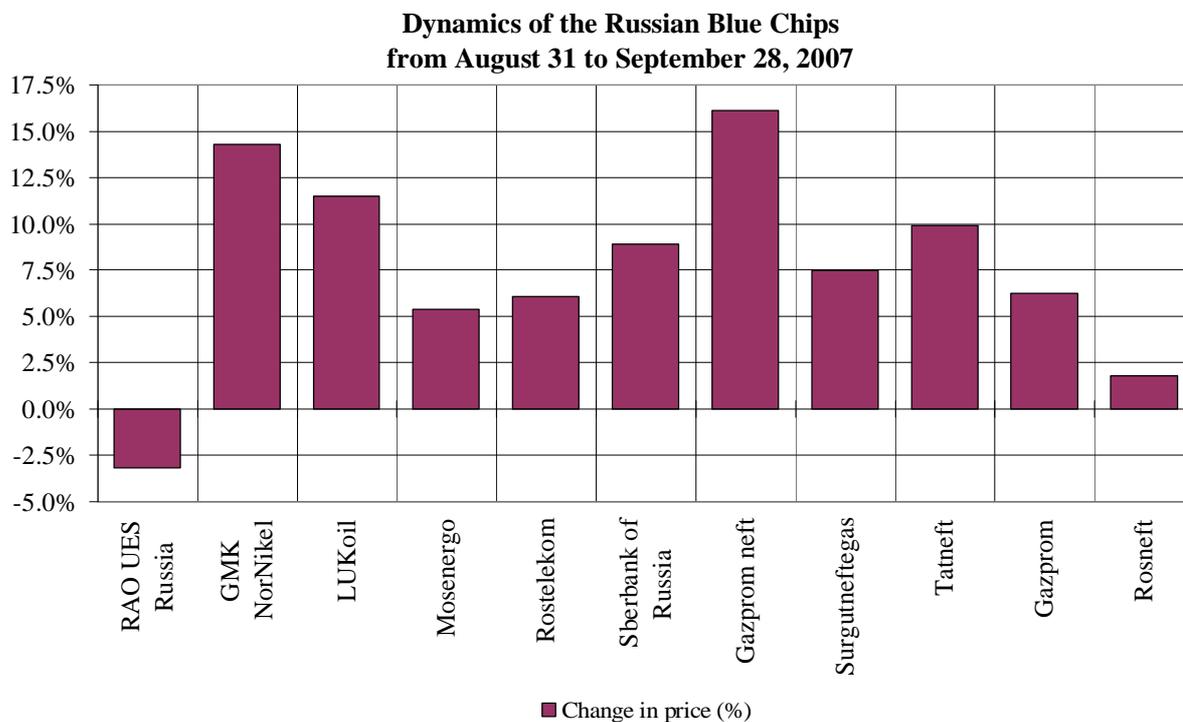


In general, within the period of September 3 to 28, the RTS index has increased by 9.45 per cent in absolute terms and made 183 points. Within the same period the turnover of trades on shares, included in the RTS index, made about USD 1086 mln at an average daily turnover at the level of USD 54 mln (as compared with about USD 1297.8 mln at an average daily turnover at the level of USD 64.9 mln in August). Therefore, the investors’ activity in the stock market in August has somewhat declined as compared with the preceding month. The indicators of maximum and minimum turnover in the market trades in September made USD 131.6 mln (as of September 19) and USD 24.33 mln (as of September 28), accordingly.

As of monthly results (from August 31 through September 28), all “blue chips” have shown a steady growth in their market values, excluding RAO UES of Russia, downgraded by -3.2 per cent. Thus, the utmost growth rates were demonstrated by “Gazprom Neft”, grown by (16.1 per cent), followed by Norilsk Nickel, whose shares grew up in price within that period by 14.3 per cent, LUKOIL (+11.5 per cent). Some

lower growth rates were observed about shares of “Tatneft” (9.9 per cent), Sberbank of Russia (8.88 per cent), “Surgutneftegaz” (7.48) per cent; “Gazprom” shares have grown by 6.26 per cent.

FIG. 4.



In September the RTS turnover leaders¹¹ were: “RAO UES of Russia” (24.6 per cent), “Norilsk Nickel” (14.7 per cent), “Gazprom” (19.7 per cent), “Sberbank of Russia and (13.6 per cent), “Nornickel” (11.2 per cent) “LUKOIL” (5.2 per cent). The total share of trades with the above companies securities has accounted to 74.2 per cent of the total RTS trading volume

In terms of capitalization, as of September 28, the top five leaders of the domestic stock market were¹²: “Gazprom” (USD 261 bln, “Rosneft” (USD 90.4 bln), “Sberbank of Russia” (USD 89.1 bln), , “LUKOIL” (USD 70.9 bln), RAO «UES of Russia» (USD 50.15 bln), “Surgutneftegas” (USD 48.86 bln).

Futures and options market

In September the investors’ activity in the RTS futures and options market (FORTS) has somewhat decreased as compared with the preceding month. Thus, in the period from September 3 through 28 the total turnover in the RTS futures and options market amounted to approximately RUR 610.6 bln (963.4 thousand of transactions, 11.4 mln of contracts) against about RUR 332.44 bln (92.64 thousand of transactions, 12.6 mln of contracts) in August.

The greatest demand, as before, was for futures: the volume of trading in futures in the period under review was RUR 577.7 bln (1042.1 thousand of transactions, 10.53 mln of contracts). Options enjoyed a far lower demand, with the volume of trading at about RUR 98.2 bln (30.9 thousand of transactions and 2.1 mln of contracts). The highest level of trading in the futures market was RUR 49.74 bln (as of September 13), the lowest was RUR 19.6 bln (as of September 17).

Corporate bond market

The corporate bond market was developing in line with other segments of the Russian financial market. The US liquidity crisis has urged an outflow of investors from emerging markets, what resulted in the pressure on quotations of Russian bonds. Domestic investors were also generally tended to restrict operations with corporate bonds or even sell securities from their portfolios to support required level of liquidity with on-going operations. The market has also positively reacted to the reduction of base interest rate in the United States. However, during September, negative trends were dominating in the market. Even despite the noticeable dollar downgrading against ruble, the problem of ruble liquidity put pressure on the quotations of corporate bonds, denominated in rubles.

¹¹ On the classical market.

¹² According to RTS data.

From September 3 through 28 the price index of corporate bonds traded on MICEX¹³ went down by 1.07 points (-0.97 per cent), while the index of the ten most liquid corporate bonds decreased by 1.15 points (-0.98 per cent). Within that period the total turnover on the MICEX corporate bond sector amounted to nearly RUR 47.5 bln with an average daily turnover of RUR 2.38 bln (about RUR 51.7 bln with an average daily turnover of RUR 2.71 bln in the relevant period of August). Therefore, the investors' activity has somewhat declined in September.

FIG. 5

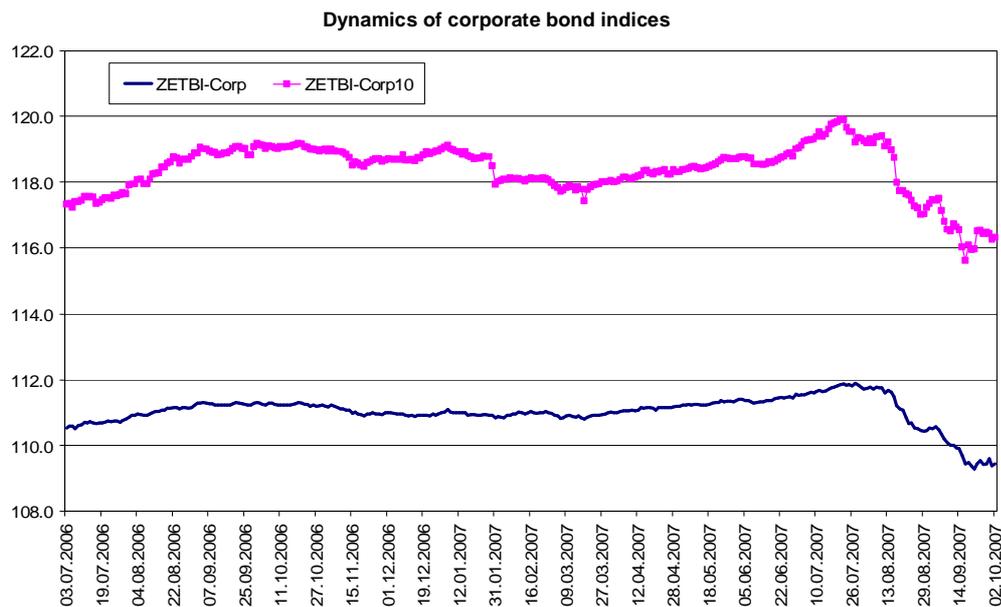
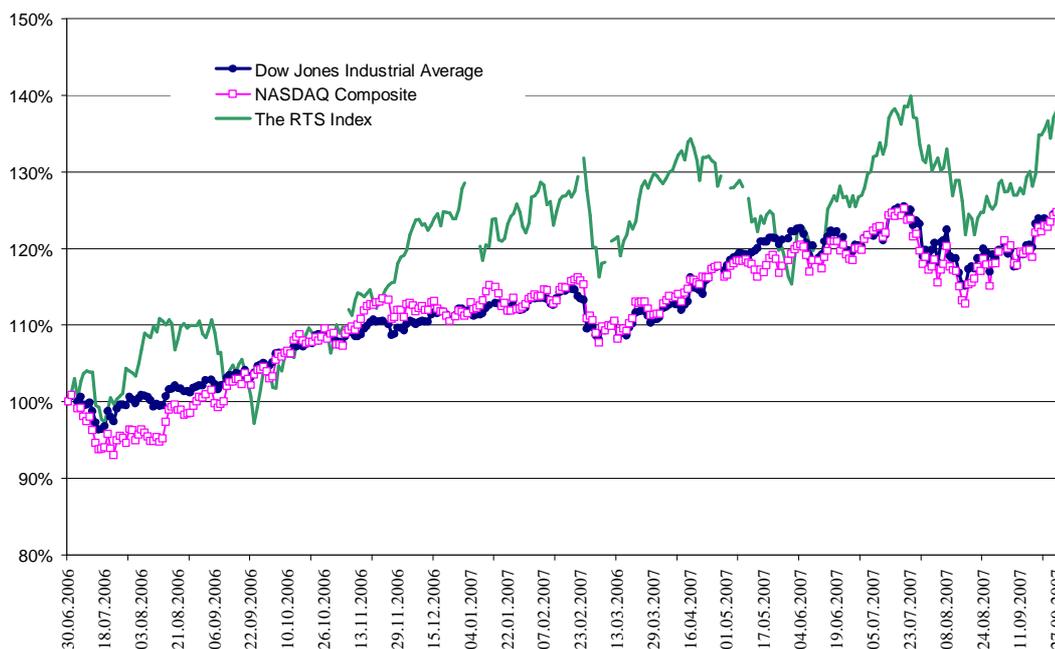


FIG. 6.



External factors behind Russian stock market dynamics

Oil market has been supporting the Russian stock market throughout September. Oil prices have reached the level of USD 80 per barrel within the month and remained close to that level until the end of September. The basic factors of considerable growth of prices for "black gold" was the information on the reduction of

¹³ The calculation was based on indices of corporate bonds traded on MICEX. The indices were produced by the Zenit bank.

fuel stock in the United States, as well as notification of the oil companies of the Gulf of Mexico on temporary suspension of oil extraction due to a forthcoming hurricane.

The situation in the world stock markets in September was developing in a rather favorable way (see Table. 1). Despite the general decline of stock indices earlier in the month, reduction of interest rates in the United States, followed by publication of macroeconomic statistics, informing on downgraded growth rates in real sector, and, as a result, likelihood of further interest rate decline, have provided substantial support to the world stock markets.

Corporate news

OAO "Gazprom Neft"

The company formed a syndicate of international banks with ABN AMRO Bank N.V., Calyon, Citigroup Global Markets Ltd. and Commerzbank Aktiengesellschaft to attract new syndicated loan of up to \$ 2.2 billion for the period of 3 years. Attracted funds will be used to fund plans of financing for expansion of the company business in upstream and downstream segments. The loan is depreciable and is granted at LIBOR rate of + 0.75 %.

OAO «LUKOIL»

In September, the company has disclosed consolidated financial reporting for the second quarter and first six months of 2007, developed in accordance with generally accepted accounting principles of US GAAP.

The net profit of the company in the second quarter of 2007 made USD 2 517 million, what is by 8.4 per cent higher than the level of the second quarter of 2006 and exceeds the indicator of the first quarter of 2007 by 93.8 %. This is an absolute record in the history of the company, achieved regardless the relative unfavorable market prices.

Herewith, the company net profit for the first half of 2007 was USD 3.816 million, the EBITDA (earnings before deducting interest, tax, depreciation and amortization) have accounted to USD 6349 million, the level of sales proceeds reached USD 35,781 million, what exceeds the level of the first half of 2006 by 7.7 %.

The dynamics of the company performance was influenced by the decline of the world oil prices, strengthening of ruble against dollar in real terms and upgrading of transportation rates. However, the negative impact of those factors was partially offset by expansion of the company business scale and its optimization, as well as some reduction of export duties and mineral extraction tax rates. Despite the decline in oil prices and tax rates, total amount of "LUKOIL" tax deductions have increased by 6.6 % as compared with the first half of 2006 and accounted to USD 12 billion, what is based on the growth of exports and retail sales of oil products.

RAO «UES of Russia»

On September 4 the first phase of restructuring RAO "UES of Russia" leading company was completed, and two power-generating independent entities were formed on its basis, OAO "OGC-5" and OAO "TGC-5". Thus, OGC-5 and TGC-5 were the first private power-generating companies in Russia, formed in the process of restructuring of energy sector. Before starting their independent business, both companies have successfully made placements of additional shares and attracted RUR 12.28 billion and RUR 11.63 billion of investments respectively. Currently, the total capitalization of OGC-5 and TGC-5 exceeds RUR 170 billion.

The list of shareholders, who will obtain shares of OAO "OGC-5", and OAO "TGC-5" in addition to their existing shares of RAO UES of Russia", was defined as of September 3, 2007. The number of shares of RAO "UES of Russia" owned by the shareholders at that point, remains unchanged in connection with formation of OGC-5 and TGC-5. Thus, the shareholders will receive 0.41 ordinary shares of OAO "OGC-5" per one ordinary share of RAO "UES of Russia" (with regard to rounding-off) and 13.59 ordinary shares of OAO "TGC-5". One privileged share of RAO "UES of Russia" is equal to 0.37 ordinary shares of OAO "OGC-5" and 12.45 ordinary shares of OAO "TGC-5".

Table 1.

Dynamics of international stock market indices

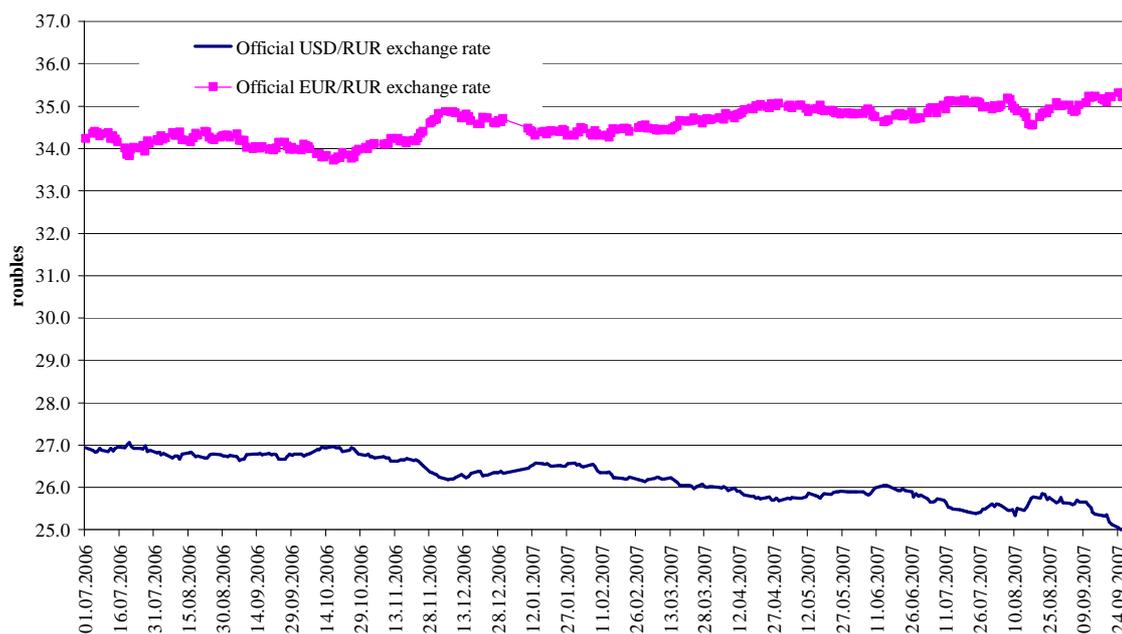
Data as of September 28	Value	Dynamics within the month(%) ¹⁴	Dynamics since the year beginning(%) ¹⁵
RTS (Russia)	2071.8	10.70%	15.19%
Dow Jones Industrial (USA) Average (USA)	13895.63	4.56%	11.49%
NASDAQ Composite (USA)	2701.5	5.40%	11.85%
S&P 500 (USA)	1526.75	4.30%	7.65%
FTSE 100 (UK)	6466.8	5.46%	3.95%
DAX-30 (Germany)	7861.51	5.68%	19.17%
CAC-40 (France)	5715.69	3.54%	3.14%
Swiss Market (Switzerland)	8933.48	2.36%	1.68%
Nikkei-225 (Japan)	16785.69	4.83%	-2.56%
Bovespa (Brasil)	60465.06	14.66%	35.96%
IPC (Mexico)	30296.19	1.97%	14.55%
IPSA (Chile)	3249	0.32%	20.64%
Straits Times (Singapore)	3706.23	11.14%	24.13%
Seoul Composite (South Korea)	1946.48	6.59%	35.69%
ISE National-100 (Turkey)	54044.22	12.40%	38.16%
Morgan Stanley Emerging Markets Free Index	1 204.90	14.98%	32.01%

Foreign currency market

As of results of the month from September 3 to 28, the official dollar rate against ruble has declined by RUR 0.97 (-2.59 per cent) from the level of the beginning of the month, when it accounted to RUR 24.878 to USD 1. Total volume of trading of the US currency in SELT from September 3 to 28 made about USD 91.6 billion with an average daily turnover at USD 4.6 billion (about USD 85.87 billion with an average daily turnover at USD 4.52 billion in August). Therefore, in September the activity of participants of foreign currency market has somewhat increased as compared with the preceding month. The maximum volume of trading in USD was recorded on September 28, when it amounted to about USD 8.6 billion, the minimum level of USD 1.5 billion was observed on September 3.

FIG. 7.

Dynamics of the Official USD/RUR and EUR/RUR Exchange Rates in 2006-2007



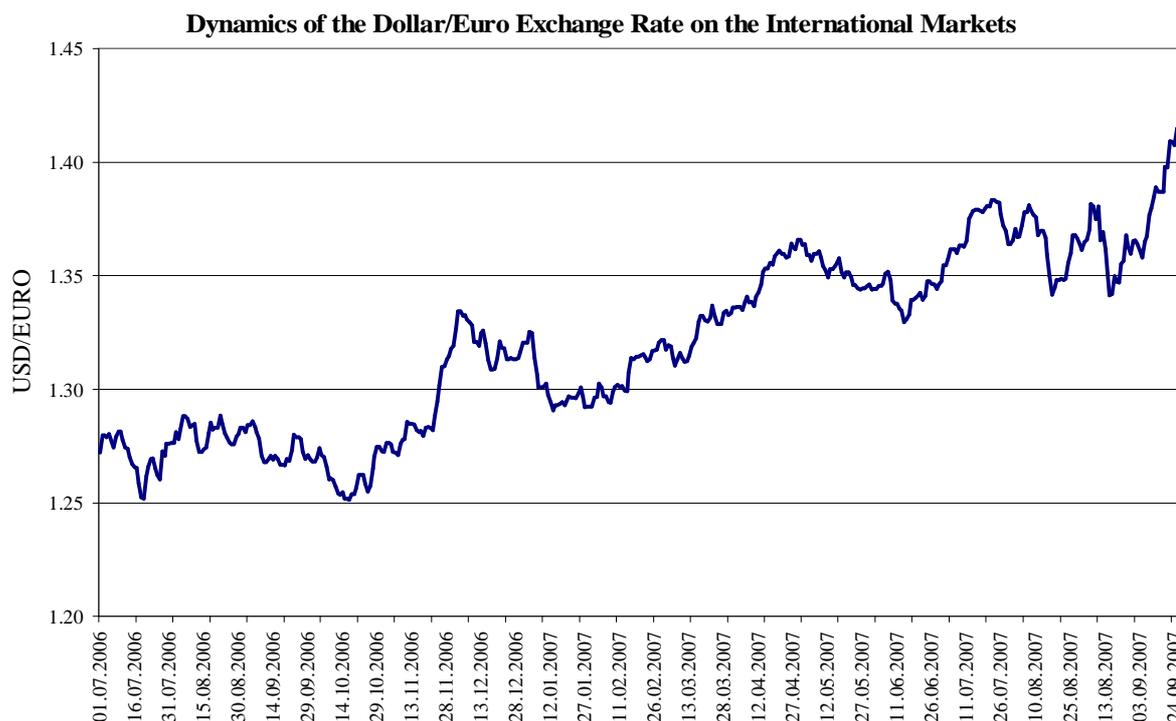
¹⁴ Versus index indicator valid on September 27, 2006.

¹⁵ Versus index indicator valid on September 27, 2006.

From September 3 to 28 Euro rate in the world market has grown by USD 0.06 (4.47 per cent) to the level of USD 1427 for EURO 1. In this background EURO has grown against RUR in the same period by RUR 0.3 (0.87 per cent), from RUR 35.02 to RUR 35.44 for EURO 1. The total volume of trading in EURO on SELT in that period amounted to about EURO 4.75 bln at an average daily turnover of EURO 237 mln (about EURO 1.82 bln at an average daily turnover of EURO 95.68 mln in August). Therefore, the activity of European currency trading in the Russian market has grown versus the level of preceding month as well.

The maximum volume of trading in EURO was recorded on September 17, when it amounted to about EURO 1.93 billion, the minimum level of EURO 121.6 million was observed on September 10.

FIG. 8.



D. Polevoy

Investments in the Real Sector of the Economy

As a result of the first half of 2007 the share of the investments in fixed assets was equal to 15.9% of the GDP as compared with 13.5% last year. Over January-August the volume of investments in the fixed assets was equal to RUR 3380.7 bln, exceeding by 22.1% the level of the corresponding period of the previous year.

The positive feature of the first half of 2007 was the sustention of the trend for the increase of bank sector participation in investment process crediting. The share of Russian banks' credits in the structure of investments in fixed assets financing grew up to 9.8%.

Over the last four years the changes in the investments structure in the fixed assets have been determined by gradual reduction in the proportion of investments in industrial production development against the background of the increase in infrastructure and services' proportion.

It is since 1999 that the trend for the anticipating growth of investments in the fixed assets as compared with GDP dynamics has been observed. In the 1st half of 2007 the increase of the investments in the fixed assets was equal to 22.3%, increase of the GDP – to 7.9% against, respectively, 11.0% and 6.0% in the corresponding period of the previous year. Over January-August the volume of investments in the fixed assets was equal to RUR 3380.7 bln, exceeding by 22.1% the level of the corresponding period of the previous year.

Steady positive dynamics of the production has changed the situation in the investment sector. Expansion of the investment demand proceeded against the background of the favorable changes in the state of affairs at the world market of hydrocarbons and minerals, on the one hand, and of the active strategy of Russian business at the internal market, on the other hand. At the same time it is the anticipating growth rates of

internal demand as compared with the external that has had the most significant impact on the level of investment demand since the 1st quarter 2005. Combined influence of internal factors regulating the level of business activity accounted for specific features in structure characteristics of fixed assets renewal.

Enterprises' and organizations' financial indices improving the change of investment in fixed assets structure was accounted for by the sustention of the tendency for the increase in borrowed funds share. The positive feature of the first half of 2007 was the sustention of the trend for the increase of bank sector participation in investment process crediting. The share of Russian banks' credits in the structure of investments in fixed assets financing grew up to 9.8%. This trend formation partially made up for reserved behavior of insurance and investment companies, industrial and trade enterprises, as well as foreign capital in the investment process financing. The proportion of organizations' and enterprises' borrowed funds in the sources of investments in fixed assets financing diminished by 0.3 p.p. as compared with the 1st half of 2006, and of foreign banks credits – by 1.5 p.p.

It should be noted that it was the change in the trends for capital flow of the domestic private sector that undoubtedly had a positive influence on the character of investments into Russian economy development financing. Since the 2nd quarter of 2006 the replacement of the trend for capital outflow by the positive phenomenon of pure capital inflow by non-financial enterprises and households has been observed. Whereas in the 1st half of 2006 net capital inflow in the sector of non-financial enterprises and households was equal to USD 8.5 bln, in 2007 according to the preliminary data net capital inflow by this category was equal to USD 29.9 bln. It should be mentioned that over 2006 on the whole the index of the net capital inflow by non-financial enterprises and households was equal to USD 13.45 bln.

The peculiar feature of the 1st half of 2007 was the increase in the share of budget funds in the structure of investment financing by 1.2 p.p. due to the expansion of funds of Russian Federation subjects participation. The share of budget funds used for investments in the fixed assets was equal to 1.9 % of the GDP in the 1st half of 2007 and exceeded the figure of the corresponding period of last year by 0.4 p.p. In order to fulfill Federal targeted investment program (FTIP) for 2007 it is envisaged to direct government investments at the sum of RUR 510.26 bln or 1.66 % of the GDP as compared with 1.37% in 2006. Over January-July 2007 investments at the amount of RUR 143.8 bln or 39.5% of annual funds limit were used at the expense of all sources of financing. .

Table 1

**Structure of Investments in Fixed Assets by the Sources of Financing in the
1st half of 2004 - 2007 (not taking into account small business and
parameters of informal activities)**

	2004	2005	2006	2007
Investments in the fixed assets	100	100	100	100
including				
Own funds	48.6	47.2	47.0	44.5
including				
Profit remaining for the enterprise management	17.3	19.4	20.8	20.1
Depreciation	24.9	22.4	23.2	21.3
Borrowed funds	51.4	52.8	53.0	55.5
including				
Bank credits	7.3	6.0	9.3	9.8
Of which foreign banks' credits	1.1	0.9	2.2	0.7
Borrowed funds from other organizations	6.0	9.7	7.3	7.0
Budget funds	16.2	17.1	15.2	16.4
including				
From the federal budget	4.2	5.0	4.9	4.6
From the budgets of the Subjects of Russian Federation	11.2	11.1	9.4	10.4
Investments from abroad in the total volume of investments in fixed assets	4.5	7.0	6.5	4.5

Source: Federal State Statistics Service

Over the last four years the changes in the investments structure in the fixed assets have been determined by gradual reduction in the proportion of investments in industrial production development against the background of the increase in infrastructure and services' proportion. It should be noted that 2006 and the first half of 2007 illustrate the upsurge in the investment activity in agriculture, which was initiated by the inclu-

sion of this kind of economic activity in the list of national priority projects. Against the background of steady growing demand for trade services redistribution of the investments by the kinds of activities proceeds in the environment of expansion of material and technical base for motor vehicles, increase of investments to which was equal respectively to 125.6% to the level of the 1st half of 2006.

In 2007 the trend for the increase of investments in the fixed assets in trade and transportation sustained, as well as in the kinds of activities, aimed at social services rendering – education (151.2% to the 1st half of 2006), health care (118.5%), activities on recreation and entertainment, culture and sport organization (137.5%). Characteristic feature of investment process in transportation in the 1st half of 2007 was the dynamic growth of investments in railway transportation (118.4% to the 1st half of 2006) investment rates in the pipeline transport being moderate (100.1%).

Table 2

**Structure of Investments by kinds of Economic Activities
in the 1st half of 2004-2007, as percentage to the total**

	2004	2005	2006	2007
Industry	46	46.1	44.5	44.8
including				
Minerals extraction	19.4	17.5	19.5	20.4
of which:				
Fossil fuels extraction	17.8	15.6	17.9	18.5
Processing industries	19.2	19.2	18.7	17.5
Electricity, water and gas production and distribution	7.4	9.4	6.3	6.9
Agriculture	3.2	3.1	3.7	4.7
Transportation	16.9	20.4	21.2	17.8
Communication	6.7	4.5	4.5	4.5
Construction	3.1	3.5	3.6	2.9
Trade	2.1	2.7	2.8	2.9

Source: Federal State Statistics Service

In the 1st half of 2007 the trend for investment in fixed assets diversification, which outlined in 2006, sustained due to anticipating growth of investments in extractive activities and first of all in fossil fuels extraction. Intensive growth of investments in fossil fuels extraction was aimed at overcoming the consequences of sharp decrease in investment activity in 2004-2005. As a result of the 1st half of 2007 extractive industries accounted for the prevailing part of the investments in the industry (45.5%). Investments in the fixed assets increasing on the whole throughout the economy by 17.5% in the 1st half of 2007, growth of this indicator in minerals extraction was equal to 20.6%, in processing industries – to 11.5% and in electricity, gas and water production and distribution – to 29.5%.

As a result of the 1st half of 2007 investments of 10 biggest oil companies was equal to RUR 168.7 bln. The largest inventions at the sum of RUR 53.8 bln were made by Rosneft, 36.7% accounting for exploring and production drilling. Oil company LUKOIL placed RUR 42.3 bln, Surgutneftegaz – RUR 37.6 bln, the proportion of expenses for exploring and production drilling being, correspondingly, 46.8% and 41.2%.

In the 1st half of 2007 investments in processing industries were equal to 39.1% of the total volume of investments in the industry and reduced by 2.9 p.p. as compared with the corresponding period of last year. The changes in the structure of investments by processing industries were defined by interaction of external and internal demand factors. Investment activity in production of foodstuffs (117.5%), textile and clothing goods (181.8%) was initiated by expansion of the demand at the internal market.

The highest investment rates were observed in the production of rubber and plastic goods (183.1%), finished metal goods production (171.6%). Decline in investments in the 1st half of 2007 as compared with the corresponding period of the previous year was registered in coke production (46.8%), metallurgic (89.3%) and chemistry (98.2%) production. Investment activity in machinery and equipment production is characterized by extremely unsteady indices: decline in the investments in the 1st quarter 2007 was compensated by the growth of business activity in the 2nd quarter and on the whole over the 1st half of the year the increase was equal to 57.3%. Difficulties in choosing the strategy for machine building production development as well as addressed support of some enterprises lead to misbalance at the markets of capital goods. It should be noted that stagnant dynamics of investments in transport vehicles production that was observed over the last two years, in 2007 gave way to dynamic growth (140.0%), which is primarily connected with intensive development of production of industrial motor vehicles assemblage.

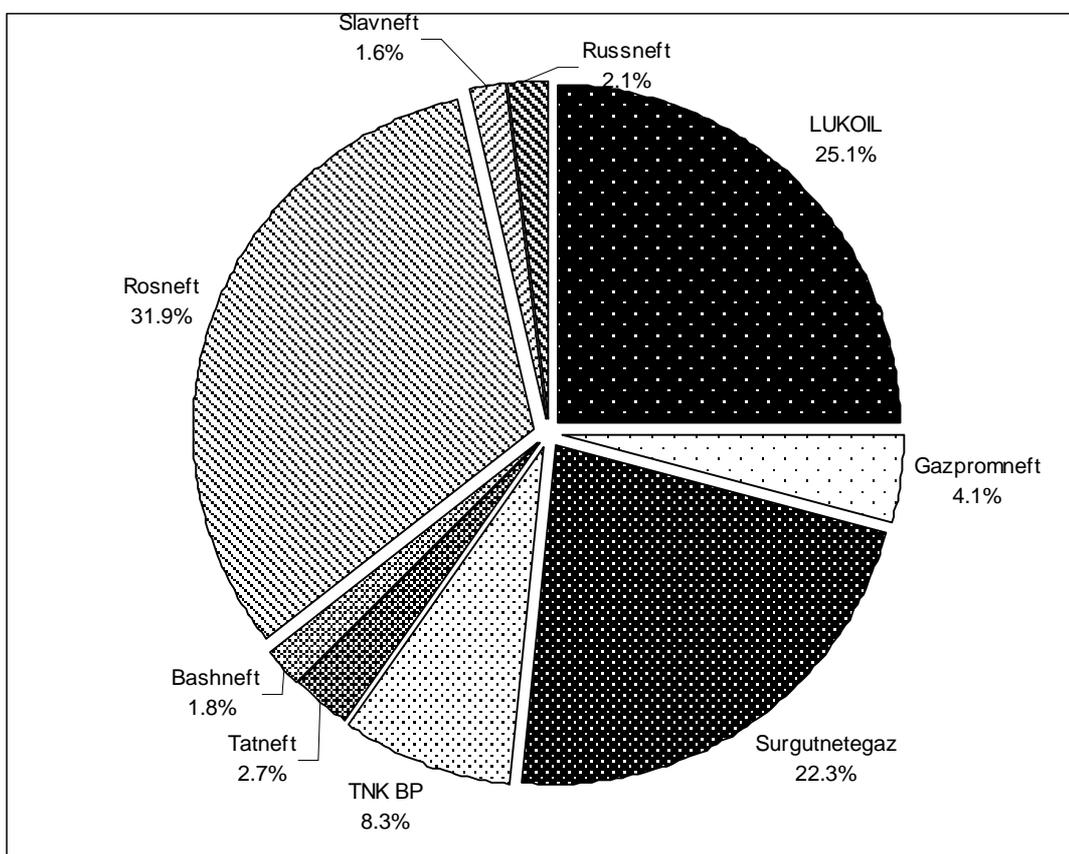


Fig. 1. Structure of the Investments by the Biggest Oil and Gas Companies in the 1st half of 2007, as percentage to the total

Source: Central Dispatching Board of the Fuel and Energy Complex

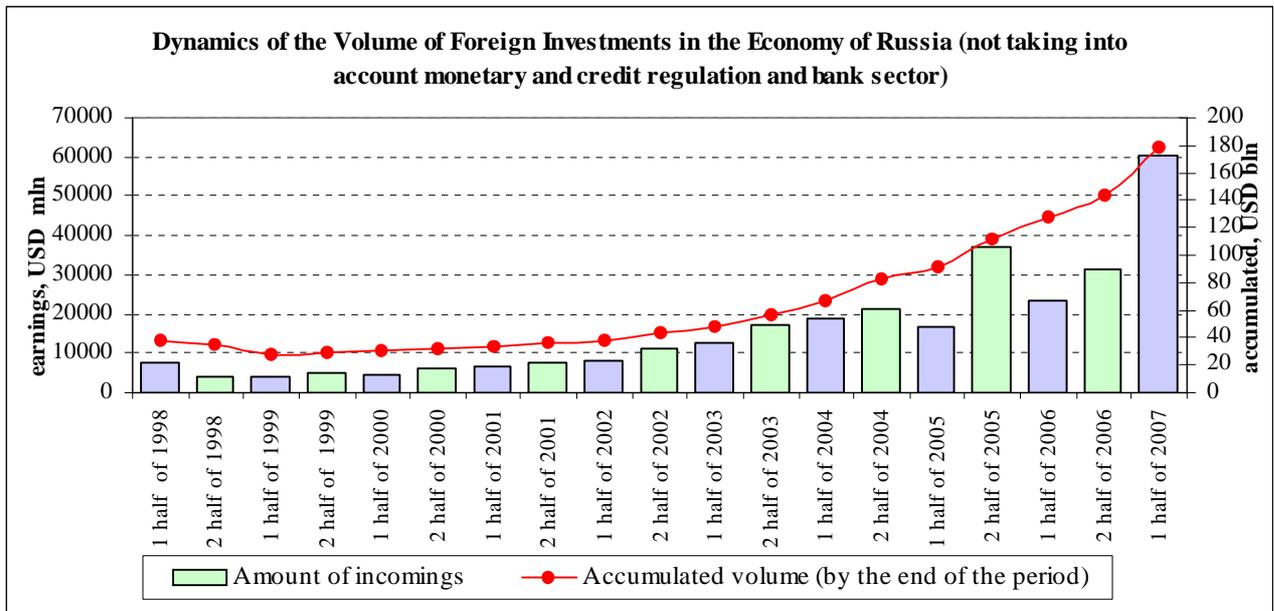
In the structure of investments by kinds of fixed assets, in the 1st half of 2007 share of machinery and equipment decreased by 1.2 p.p. and was equal to 35.0%. Domestic machine building does not however meet the growing investment demand either by volume or by structure of capital goods offer. Investments in foreign equipment purchase in 1st half of 2007 were equal to 18.6% of the total volume of investments in machinery, equipment and transport vehicles. Under existing structure of domestic production of capital goods import remains one of the main sources for fixed capital renewal, production reconstruction and modernization.

On 16 August international Rating Agency Fitch confirmed Russia's rating at the level of "BBB+" with the stable forecast. Fitch noted strong position of Russia both in the part of government finance and in the part of external debt. In the opinion of Fitch, favorable effects connected with high prices for oil and increase in investments compensate structural weaknesses of Russian economy, including imperfections of business climate, low quality of corporate management and insufficient development of bank sector.

O. Izryadnova

Foreign Investments in Russian Economy

In the first half year of 2007 intensification of foreign investors activity in Russian Federation was observed. According to the state of affairs by 1 July 2007 accumulated investments into Russia, including investments from CIS-countries, reached USD 178.5 bln, being by 39.5% higher than the level reached by 1 July 2006 and exceeding by 24.9% the figure at the beginning of the current year. Over the first half of 2007 foreign investments into the Russian economy went up as regards the corresponding period of the previous year by 2.6 times and were equal to USD 60.3 bln (in the first half year of 2007 their growth was estimated to be 41.9%).



Source: Federal State Statistics Service

In the first half year of 2007 USD 25.2 bln was spent in the form of foreign investors' profits transferred abroad as well as interest payments for credits used and credits repayment, which is by 41.4% higher than the figure for the corresponding period of the previous year. This comprised 41.7% of the volume of incoming foreign investments (in 1 half of 2006 – 76.1%).

The same as in the preceding years, it is the other investments that steadily hold the leading position in the structure of foreign investments, flowing into the Russian economy – in the first half of 2007 they accounted for 71.9% of the total volume of the foreign investments coming into the Russian Federation. For the last years the trend of decreasing of the proportion of direct investments in the structure of foreign investments into Russian economy has been observed (2007 – down to 17.0%, 2006 – down to 17.8%).



Source: Federal State Statistics Service

In contrast to 2005-2006, as a result of the first half of 2007 the growth rates of the direct investments were behind the corresponding figures of other and aggregated foreign investments, which led to the decrease in the proportion of direct investments: from 27.5% in the first half of 2006 to 26.3% in the first half of 2007.

Table 1

Structure of Foreign Investments into the Russian Economy in the First Half of 2002-2007

	As USD mln				As percentage to the previous year			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
2002	8 368	1 872	199	6 297	125.2	74.6	83.6	159.9
2003	12 662	2 533	38	10 091	151.3	135.3	19.1	160.3
2004	18 983	3 427	129	15 427	149.9	135.3	103.4	152.9
2005	16 503	4 489	175	11 839	86.9	131.0	135.2	76.7
2006	23 410	6 445	499	16 466	141.9	143.6	285.1	139.1
2007	60 343	15 837	1 103	43 403	257.8	245.7	221.0	263.6

Source: Federal State Statistics Service

In the first half of 2007 structure of foreign investments attracted to the Russian Economy by branches of industry was characterized by dynamic growth of investments in industry, trade and catering. As compared with the corresponding period of 2006, in first half of 2007 the growth rates of investments into these branches increased, respectively, by 2.3 and by 5.1 times.

Table 2

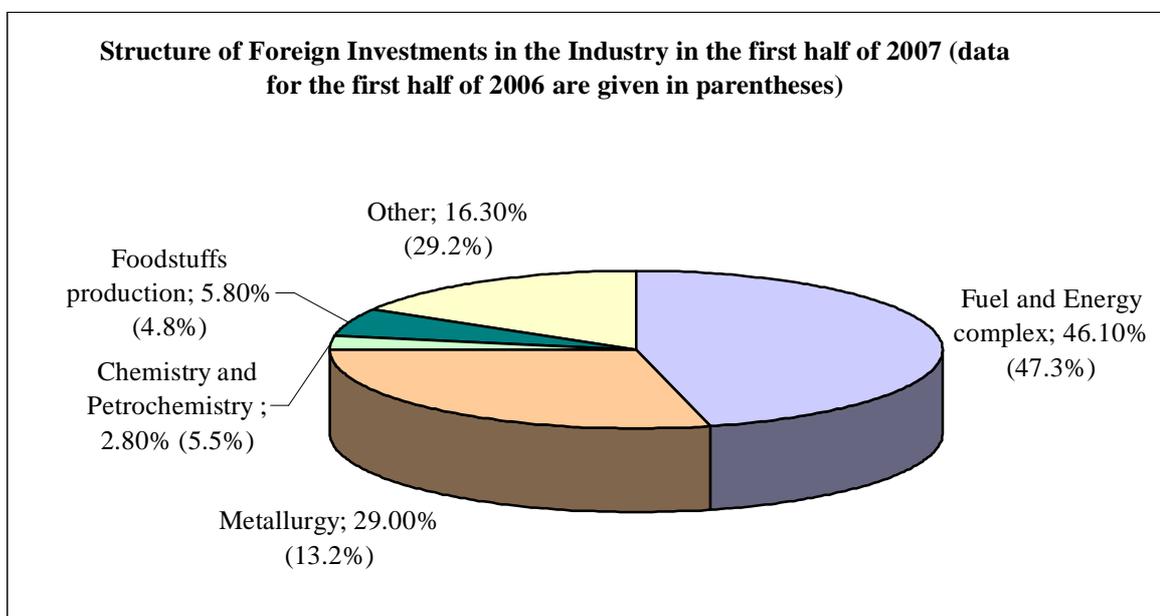
Structure of Foreign Investments into the Russian Economy in the First Half of 2004-2007 by Branches

	As USD mln.				В % к итогу			
	2004	2005	2006	2007	2004	2005	2006	2007
Industry	10 250	8 026	11 353	26 295	54.0	48.6	48.5	43.6
Transportation and communication	337	1 677	3 946	3 550	1.8	10.2	16.9	5.9
Trade and catering	6 113	4 917	5 092	25 973	32.2	29.8	21.8	43.0
Commercial activity on market service	924	1 153	1 240	2 071	4.9	7.0	5.3	3.4
Finance, credits, insurance, pensions provision	468	526	1 387	1 232	2.5	3.2	5.9	2.0
Other sectors	891	204	3 892	1 222	4.6	1.2	1.6	2.1

Source: Federal State Statistics Service

In the first half of 2007 the volumes of investments in transportation and communication decreased as compared with the first half of 2006 by 10.0%. Against the background of growth of the investments in other branches and increase in total investments, the share of transportation and communication decreased in three times down to 5.9%.

As a result of the 1 half of 2007 the most attractive branches in the industry were processing ones, where USD 13.5 bln was invested (51.3% of the investments directed to the industry), which is by 2.5 times more than the corresponding figure for the first half of 2006. USD 12.7 bln was invested in minerals extraction in the first half of 2007 (which exceeds by 2.2 times the figures for 1 half year of 2006). Over the period considered investments in fossil fuels extraction increased by 2.3 times (up to USD 12.1 bln, in chemistry industry – by 15.4% (up to USD 725 mln), in metallurgy -by 5.1 times (up to USD 7.6 bln) and in foodstuffs production - by 2.8 times (up to USD 1.5 bln). Thus, the structure of foreign investments in industry in 1 half year of 2007 suffered some changes.



Source: Federal State Statistics Service

In 2007 the trend for the increase in the share of direct foreign investments in the structure of investments in the industry, which as a result of the 1 half year was equal to 49.3% (1 half year of 2006 – 40.2%), sustained. The share of portfolio and other investments in the industry over the period of the current year under examination is estimated at 48.3% and 2.4% (in 1 half of 2006 – 57.3% and 2.5%, correspondingly).

It was in the industry where the biggest part - 81.8% (in 1 half of 2006 - approximately 70%)- of the foreign investments into the economy flowed.

Table 3

Structure of Foreign Investments into the Industry in 1 half of 2007

	As USD mln			Change as to 1 half of 2005		
	Direct	Portfolio	Other	Direct	Portfolio	Other
Industry	12961	632	12702	284.0%	219.4%	195.4%
including:						
Minerals extraction	11174	18	1458	327.7%	100.0%	59.5%
Metallurgy	131	39	7459	189.9%	29.8%	574.2%
Chemistry and Petrochemistry	104	9	612	70.7%	225.0%	128.3%
Foodstuffs production	806	22	686	347.4%	in 22 times	219.9%
Other branches	746	544	2487	105.8%	357.9%	126.6%

Source: Federal State Statistics Service

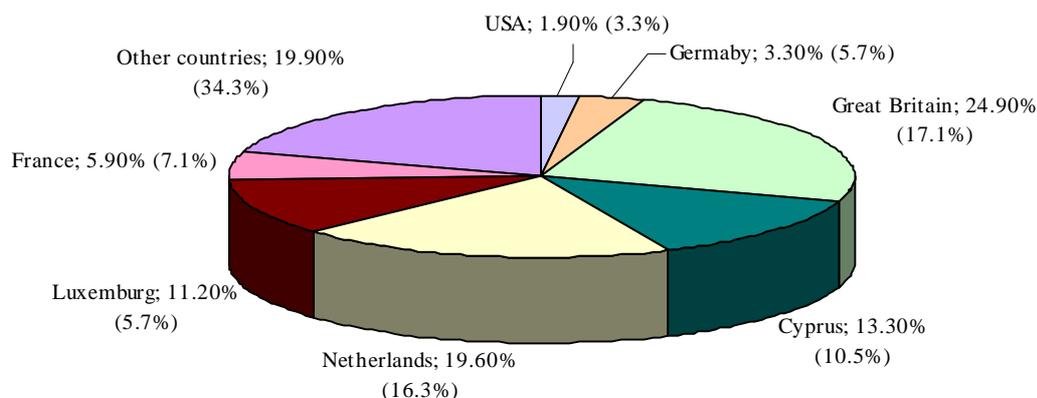
In the first half of 2007 approximately 70% of the foreign investments made by direct investors were supplied to extractive industry (in 1 half of 2006 – 51.2%), 11.0% were placed into processing industry (1 half of 2006 – 17.5%), 4.0% - to trade and catering (1 half of 2006 – 4.4%), 5.2% - to operations with real estate and service rendering (1 half of 2006 – 8.5%).

Coke and oil products production were of greatest interest for portfolio investors – USD 458 mln or 41.5% of the total amount of portfolio investments into the Russian Federation were directed there (1 half of 2006 – USD 29 mln or 5.8%), as well as communication – USD 381 mln or 34.5% (1 half of 2006 – USD 134 mln or 26.9%).

Other investments in the industry are estimated to be 29.3% of the total amount of other investments in the economy in the first half of 2007 (in 1 half of 2006 – 28.5%). Other investments in the field of trade and catering were equal to 58.4% (1 half of 2006 – 29.2%), in transport and communication – 6.9% (1 half of 2006 – 22.1%).

Some changes in regard to the previous year were observed on geographical structure of foreign investments attracted in the first half of 2007.

Geographic Structure of Foreign Investments, received by Russian Economy in the 1 half of 2007 (the data for the first half of 2006 are given in parentheses)



Source: Federal State Statistics Service

The same as in the previous year in the first half of 2007 it was the Great Britain that held the leading position in the list of the biggest countries that export capital to the Russian economy – it increased its investments into the Russian Federation up to USD 15.0 bln, which is by 3.8 times more than the figure of the first half of 2006.

The second place is still occupied by the Netherlands, which invested USD 11.8 bln in the Russian economy in the first half of 2007, exceeding by 3 times the figures for the first half of 2006. Cyprus investments in the first half of 2007 increased by 3.3 times up to USD 8 bln.

Investments from Luxemburg increased by 5 times as compared with the corresponding period of 2006 up to USD 6.7 bln. The fifth place in the list of countries exporting capital into Russia is held by Switzerland, which as a result of the first half of 2006 was not even among the first ten countries that export capital into the Russian Federation. Total investments from Switzerland are estimated to be USD 3.7 bln. The investors from Switzerland gave preference to metallurgy, which share in the investments from that country to the Russian Federation was equal to 77.0%.

The structure of investments by three main countries, whose investors placed the biggest amount of the capital into the Russian Economy broken by branches of industry can be represented as the following:

Table 4

Structure of Foreign Investments for the Leading Countries, Exporting Capital to the Russian Federation in the First Half of 2007 (data for the first half of 2006 are given in parentheses)

	Great Britain		Netherlands		Cyprus	
	As percentage to the total	As percentage to the total investments into the branch	As percentage to the total	As percentage to the total investments into the branch	As percentage to the total	As percentage to the total investments into the branch
Processing industry	2.6 (20.3)	2.9 (15.3)	5.1 (2.7)	4.5 (1.9)	13.3 (21.7)	7.9 (10.1)
Trade and catering	93.3 (56.0)	54.0 (44.0)	No data	No data	48.5 (16.9)	15.0 (8.2)
Transportation and communication	No data (19.8)	No data (20.1)	No data (39.6)	No data (38.4)	3.8 (No data)	8.5 (No data)
Minerals extraction	No data	No data	91.0 (43.5)	84.9 (28.4)	4.9 (н.д.)	3.1 (No data)
Commercial activity	0.8 (No data)	5.8 (No data)	No data (4.2)	No data (13.1)	15.6 (18.9)	60.4 (37.7)
Financial activity	No data	No data	No data	No data	No data (23.1)	No data (41.0)

Source: Federal State Statistics Service

At the same time in the first half of 2007 10 biggest investors accounted for 88.5% of the total volume of investments accumulated by 1 July (in 1 half of 2006 – 85.9%). The share of the first ten countries that export

capital into Russia in the accumulated direct investments is 87.7% (in the first half of 2006 – 85.5%), in accumulated portfolio and other investments – 88.8% (68.4%) and 89.0% (87.1%), correspondingly.

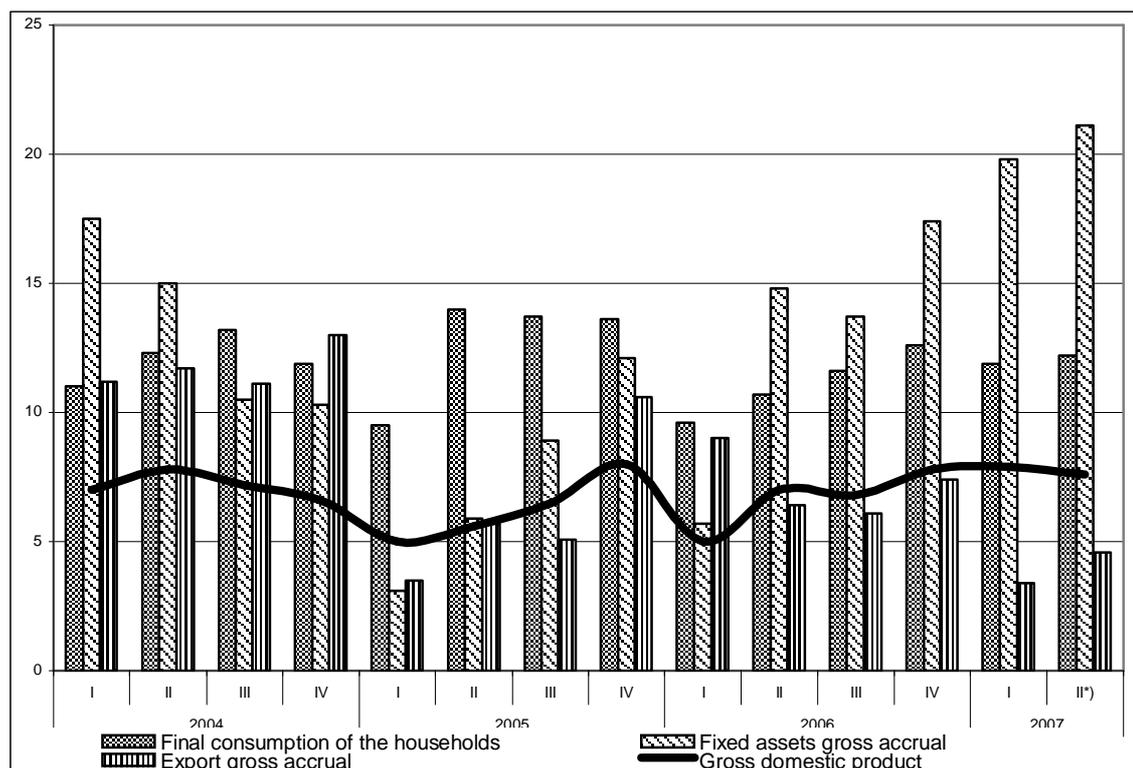
E. Ilyukhina

Real Economy Sector: Trends and Factors

According to the preliminary data for the first six months of 2007 the increase of the GDP was equal to 7.8% against 6.3% over the corresponding period of the previous year. The structure and the dynamics of the GDP produced were influenced predominantly by the high rates of workload increase in the construction, which reached 25.5% against 8.3% in the previous year. As a result of the first six months of 2007 the increase in processing industries was equal to 12.2% against 4.5% in the corresponding period of the previous year, of extractive industries – to 3.0% against 2.3%.

In the structure of the used GDP the share of investments in the fixed assets was equal to 15.6% over the first six months of 2007, exceeding by 2.1 p.p. the figure over the corresponding period of the previous year.

Characteristic for the first half of 2007 was the acceleration of the economic growth rates in nearly all types of economic activities. According to the preliminary data for the first six months of 2007 the increase of the GDP was equal to 7.8% against 6.3% over the corresponding period of the previous year. The structure and the dynamics of the GDP produced were influenced predominantly by exceptionally high rates of workload increase in the construction against the background of the sustention of the trend for steady growth of the trade turnover, communication services, financial services, and paid services for the population. In the first half year of 2007 the increase of the work in the construction was equal to 25.5% against 8.3% in the previous year and was supported by the growth rates of investments in fixed assets growth up to 22.3% against 11.0%. In the structure of the used GDP the share of the investments in the fixed assets was equal to 15.6% over the first six months of 2007, exceeding by 2.1 p.p. the figure for the corresponding period of the previous year. In this connection it should be underlined that since the second half year of 2006 the trend for anticipating growth of gross accrual in fixed assets as compared with the final consumption of households has been observed, which was the factor that compensated the reserved growth of export.



*) preliminary estimation.

Fig. 1. Change of the GDP Growth by the Components of the Final Consumption in 2004-2007 as percentage to the corresponding quarter of the previous year

The increase of business activity in the field of investments was the factor that generated the expansion of the domestic demand. Increase in the industry production over the first half year of 2007 was equal to 7.7%, exceeding by 3.3 p.p. the figure of the previous year, and the increase in processing industries – to 12.2% against 4.5% over the corresponding period of the previous year. On comparing the dynamics of the industries development the dramatic widening of the gap between kinds of activities as well as slowdown of the export growth rates, 4/5 of which is formed by minerals and raw materials, is notable.

The acceleration of the processing industries growth rates was most significantly influenced by the increasing demand for building and construction materials, machinery and equipment. The index of machinery production was equal to 123.4% against the decrease of 8.7% over the corresponding period of the previous year, electronic and optical equipment – by 123.4% against 105.5%, transport vehicles and equipment – by 114.9% against 105.6%. The production of the construction materials increased on average by 17.3%.

Statistics observes the trend for the decrease of export share in the production output of the main goods, which is accounted for by the expansion of the internal market demand as well as stagnant dynamics of the export growth in terms of physical volume along with sustention of the trend for prices for the traditional goods of Russian export at the world market growth. In monetary terms export growth rates have slowed down to 9.8% in January-May 2007 as compared with 31.1% in the previous year.

Analyzing dynamics and structure of internal demand the strengthening of the trend for import growth should be noted. High elasticity of the import against internal demand demonstrates that along with the economy and population incomes growth and the decrease in the competitiveness of the domestically produced goods the shift of the consumer's preferences to the import goods is intensifying. Import increase over January-June 2007 was equal to 59.7%, exceeding by 21.2 p.p. the level of the corresponding figure of the previous year. In the amount of the retail trade resources the share of import supplies increased up to 48%, including for foodstuffs – up to 38% and for non-food goods – to 56%.

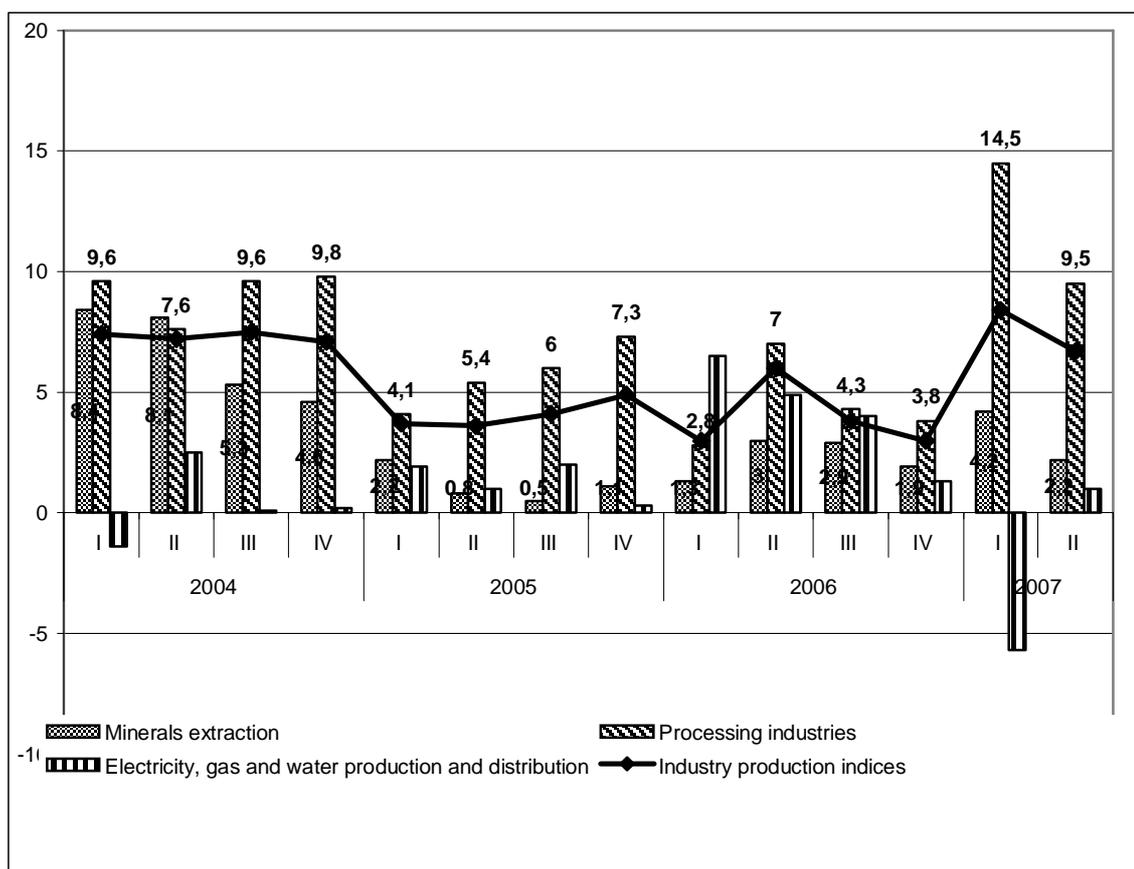


Fig. 2. The change of the Industry Production Growth Rates by the kinds of Economic Activities in 2004 – 2007, as percentage to the corresponding quarter of the previous year

Increase of solvent demand accounted for intensive growth of the retail trade turnover. The same as in the past three years increase of trade turnover was mostly influenced by the anticipating growth of non-food goods market. The retail trade turnover increasing by 14.2% as compared with the first half year of 2006, the increase of foodstuffs sales was equal to 12.4%, of non-food goods – to 15.7%. To a certain extent this was

accounted for by structural shifts of prices for main goods groups. The consumer prices having increased over the first half year of 2007 by 5.7%, the prices for foodstuffs since the beginning of the year have increased by 6.1%, and for non-food goods – by 2.2%, for paid services – by 9.8%.

Steady expansion of the households' final consumption in the current year was determined by the improvement of the social indices of the economic development.

Increase of the population's real incomes in the first half year 2007 was equal to 11.2% against 10.2% in the corresponding period of the previous year, real wages – to 17.5% against 12.3%.

In January-May 2007 the volume of monetary incomes of the population was RUR 7377.4 bln and increased by 20.8% as compared with the corresponding period of 2006. The population spent for goods purchase and services payments RUR 5346.0 bln, which is by 22.0% more than in January-May 2006. Savings over this period were equal to RUR 1057.1 bln, which is by 1.7% less than over the corresponding period of the previous year. The share of consumer goods in the structure of monetary incomes use was equal to 72.5% in the first half year of 2007 (71.7% in 2006), including for goods purchase – 55.1%, for savings – 9.0%, for currency purchase – 5.3%. The dynamics of the demand and the structure of the population's expenditures were considerably influenced by the expansion of the consumer crediting scale. By the beginning of May 2007 the volume of the credits granted to natural persons was equal to RUR 23338.9 bln against RUR 1351.3 bln over the corresponding period of the previous year. In this connection it should be noted that one of the characteristic features of the population's expenses structure change is the increase of expenses for compulsory fees and installments payments, including the payments for insurance and loans interest. Since wage earners labor remuneration accounts for nearly 70% of the accumulated incomes of the population, one of the main aspects that determines the parameters of social development is the increase of population employment level.

According to the data of the Federal State Statistics Service on the selective investigation of the population on the employment problems, the number of the employed in the economy has increased by approximately 1.2% as compared with the corresponding period of the previous year and was equal to 69.7 mln of people. Steady economy growth of the recent years and considerable revival in the real economy sector created conditions for demand expansion at the enterprises and organizations for qualified staff and, first of all, experienced personnel. Tension coefficient (the ratio of the unemployed people to one vacant post) decreased from 2.2 in January to 1.3 in June of the current year. The total number of the unemployed, calculated by the methodology of the International Labor Organization, decreased from the beginning of the year by 200 thou. of people, reaching by the beginning of June of the current year 5.1% (6.9% of the economically active population).

Against the background of the production rates acceleration the trend for the increase of the gap between the labor efficiency and wages growth rates sustains. The maintenance of the dynamics of the internal market in such conditions is accompanied with the incomes redistribution from the enterprises to the population, which leads, in the end, to the increase of production expenses and decrease in the production profitability. As a result of the 1 quarter 2007 the share of labor remuneration in the GDP was equal to 51.4%, exceeding by 5.0 p.p. the level of the previous year.

Table 1.

The Structure of the GDP by the Sources of Incomes, in 1 quarter of the corresponding year, as percentage to the total

	2004	2005	2006	2007
Gross domestic product	100	100	100	100
including:				
Wage earners labor remuneration (включая hidden and payments for social insurance)	49.2	47.3	46.4	51.4
Net taxes for production and import	14.7	19.5	22.4	18.6
Gross economy profit and gross mixed incomes	36.1	33.2	31.2	30.0

Source: Federal State Statistics Service

However, the possibilities of further increase of the expenses for labor remuneration began to be restricted by the changes of competitive environment at the goods market as a result of ruble appreciation and the growth of pressure from import.

As a result of 1 quarter 2007 the economy profitability was equal to 13.3% against 15.1% over the corresponding period of the previous year. The highest level of the profitability is sustained in the productions connected with minerals extraction and processing, for which over the past two years the rapprochement of the labor efficiency and wages growth rates is characteristic. In the processing industries average monthly

accrued wages is about 45% of the figure for extractive industries and its dynamic growth is the factor for the attraction of the qualified labor force.

Disproportions in labor remuneration lead to the flow of reducing labor resources to the economy sectors of high profitability, which contributes to the rise of the deficit of the specialists and qualified workers in the majority of the processing industries, which is a limitation factor for the development of processing industries, economy diversification and efficiency increase.

Table 2.

Profitability of the Sold Goods, Production, Jobs, Services and Assets of the Organizations by kinds of economic activities in 1 quarter of 2005-2007, as percentage

	Profitability of sold goods, products, jobs and services			Assets profitability		
	2005	2006	2007	2005	2006	2007
Total	15	15.1	13.3	2	2.5	2.2
Minerals extraction	27.1	36.7	22.9	3.7	4.6	2.9
Processing industries	18.6	16	16.5	3.2	3.3	3.2
Electricity, gas and water production and distribution	13.8	10.5	10.7	2.1	2	1.9

Source: Federal State Statistics Service

O. Izryadnova

Business Survey in September 2007

Negative changes were registered in Russian industry in September due to the continuing decrease in demand growth rates. Satisfaction with sales' volume decreased dramatically, production growth rates dropped, enterprises reconsidered the estimations of finished commodities' stocks. The forecasts for demand and output growth turned out to be the most moderate for 2007.

In August, according to the data of the Federal State Statistics Service, the growth of industrial output held up. Taking into account seasonal and calendar factors, by estimation of the Center for Macroeconomic Analysis and Short-Term Forecasting, output volume of industrial goods as compared with the previous month suffered nearly no changes (decrease by 0.1%). With regard to the corresponding period of last year index of industrial production growth was equal to 3.8% in August against 7.8% in July (over January-August – 7.0%). As usual, experts suggest different explanations for August drop, following recent June upsurge in the Russian industry. Base effect is mentioned (a year ago the industry was growing faster than on the average over the year), as well as anticipating import growth, Gazprom is accused of decreasing gas export because of abnormally warm last winter, population incomes growth is blamed since it allows to have full-time leaves in August. But all the analysts are not disposed to talk about sudden change in long-term trend for industry growth. Unfortunately, September data can add pessimism to the estimation of the Russian industry dynamics.

First, growth rates of solvent demand for industrial products continued to decrease. According to the initial data over September they declined by 4 points, over the 3rd quarter – 8 points, and over the last 6 months – 29 points. September growth rates were the lowest since the beginning of 2006 (not taking into account January holidays). Excluding seasonality demonstrated the sustention of demand growth rates at the level of August, which is the lowest over the last 18 months. Exclusion of seasonal fluctuations gave the decrease of the figure by 1 point as compared to August down to the worst figure for the last 18 months. It appears that the period of relatively high and demand steady growth rates that started in 2nd quarter 2006 has ended.

Second, the estimations of the demand volumes by enterprises confirms the latter conclusion. In September the share of “normal” replies decreased by 6 points at once and became the lowest for the last 6 months. At the moment only 66% of the Russian industrial enterprises are satisfied with the demand for their production, 28% consider its volumes as “below the norm”. Over the last month 14% of the enterprises that took part in both August and September survey reconsidered their estimations of volume of demand estimations towards degradation (above the norm -> normal, normal -> below the norm).

Third, production growth rates decreased considerably as well. First (initial) data demonstrated the decrease in balance growth rates by 20 points at once. On excluding seasonality, the decrease was equal to 8 points and after exclusion of occasional fluctuations – 4. In any case, September results were the worst over the last 24 months. Slowing down of output growth rates occurred in all the branches. A sharp decrease of output growth rates however enabled to achieve an unprecedented balance of demand and offer in the indus-

try: in September the same dynamics for demand and offer was observed for 77% of the enterprises, which is an absolute record for all the period of the monitoring. The share of the enterprises for which production outstrips demand, on the contrary, went down to the absolute minimum (14%).

Fourth, dramatic changes occurred concerning estimations of finished stocks. The share of enterprises with normal estimations decreased from 67 to 58% over the month, the share of “above the norm” estimations increased from 16 to 22%. Calculations based on microdata demonstrate that as compared to August 16% of the enterprises reconsidered their estimations of stocks towards deterioration, mainly replies “normal” were replaced with replies “below the norm”. 70% of enterprises did not make changes in their stocks estimations. Thus, apparent decrease in the demand growth rates made the enterprises reduce output intensity and correct estimations of finished commodities estimations.

Fifth, the growth of real profit in industry ceased. Balance (growth rates) of this figure, upon reaching in the 1st quarter 2007 its historical maximum (+18 b.p. according to initial data and +7 b.p. according to those cleared from seasonality) has lost its growth potential (balances being at the moment +1 and –2 b.p., correspondingly). Profit growth was observed only for chemistry, petrochemistry and construction materials industry.

Forecasts for changes in demand and output do not make estimates for Russian industry prospects to the end of the year any more optimistic. Both demand and output in the forthcoming months will be growing by most moderate rates for 2007. Increase in output growth rates in the 4th quarter is possible only for machine-building, other branches are planning either growth slowing down or absolute decrease in production. For 74% of expectations the output dynamics will coincide with demand dynamics and for only 19% of enterprises the changes in output will anticipate the changes in products sales. This is one of the best correlations for 2007. Two months ago 67% of the enterprises planned output in accordance with the demand dynamics and 26% expected anticipating production growth. More intensive sales growth at the ended of the year is forecasted only for machine-building.

Does Russian Industry Need Immigrants?

The shortage of work force in Russian industry, which, according to the IET surveys, has been registered since 2000, reached disastrous levels. In the 3rd quarter 2007 27% of enterprises declared that they lack staff. The shortage of human resources is especially high in light industry (49% of enterprises), machine-building (34%) and construction materials industry (28%). It is with the employment of qualified workers that the biggest problems arise (see April issue of Business Survey Bulletin). Since it is difficult to expect extensive staff recruiting from the reduced system of vocational education, enterprises can try finding missing employees among the immigrants, whose flow into Russia does not exhaust. However it appears that even that source won't save Russian industry from the staff deficit.

Obstacles for Immigrants Recruiting in 2006 and 2007

	2006	2007
1. there is not a sufficient number of immigrants in the region	27	37
2. they do not apply to us looking for a job	23	20
3. difficult procedure of their recruiting	24	19
4. they have got overrated wages expectations	3	1
5. we are not satisfied with immigrants' qualification	7	15
6. we are not satisfied with their culture, way of thinking, style of work	1	2
7. we prefer not to take employ immigrants regardless of their skills	5	10
8. we have no need to recruit new employees	11	9
9. we have enough applicants out of local inhabitants	26	28
10. other	6	5
11. no obstacles	8	6

Sources: March (2006 and 2007) surveys conducted by IET

First of all, enterprises employ immigrants mainly for unskilled work (this was the case for 88% of the enterprises in March 2006, in 2007 this question was not asked, but fundamental changes in this respect are unlikely). Only 4% of the enterprises reported that they use immigrants for semiskilled work. March survey 2007 revealed that 77% of the enterprises do not have problems with unskilled workers recruitment. It is however possible that enterprises started to try immigrants as skilled workers and ... got disappointed. 15% of enterprises are not satisfied with the immigrants' qualification while a year ago the dissatisfaction with there training was only 7%. It is to be noted that at the moment Russian enterprises are quite politically cor-

rect: only 1-2% of the interrogated mention “culture, way of thinking, style of work” as obstacle to recruiting.

Second, enterprises began to notice fewer immigrants in the regions they are situated. Whereas in 2006 27% of enterprises mentioned absence of immigrants in the region as an obstacle for their recruiting, there are 37% of such enterprises in 2007. It is the enterprises of chemistry and petrochemistry (2006 – 52%, 2007 – 62%), timber and wood processing industry (39 and 38%, correspondingly), machine building (28 and 32%), light industry (24 and 59%) that especially suffer from the lack of the immigrants in surroundings. Immigrants however started to apply to industrial enterprises while looking for a job more often. In 2006 23% of enterprises were dissatisfied with their lack among applicants, and in 2007 there are 20% of such enterprises. This is a matter of particular concern in machine building (27 and 25%, respectively), foodstuffs production (32 and 16%) and light (22 and 24%) industries. In case there are immigrants in surroundings and they apply for jobs at enterprises, the dissatisfaction with their qualification differs among the branches.

Third, some enterprises adhere to quite a rigid position of “we prefer not to take employ immigrants regardless of their skills”. Their share in 2007 reached 10%. This position is especially widespread in timber and wood processing industry (15%), machine-building (14%) and foodstuffs production (13%). These figures deteriorate a bit positive impressions from the political correctness.

Fourth, level of difficulty of immigrants’ registration for work has not changed significantly for the enterprises. Whereas in 2006 this was an obstacle for 23% of the enterprises, now it is so for 19%. Comparatively more frequently this obstacle is cited in the industry of construction materials (53 and 39%).

Fifth, at more than a quarter of enterprises immigrants compete with local citizens while recruiting and are at disadvantage. 26-28% of the enterprises have enough applicants from local citizens and consider this fact to be an obstacle for immigrants’ recruiting. This figure varies significantly by branches of industry (see table).

**Share of Enterprises with Sufficient Number of Applicants
from the Local Citizens in 2006 and 2007, as percentage**

	2006	2007
1. Chemistry and petrochemistry	27	16
2. Machine building	23	35
3. Timber and wood processing industry	8	20
4. Construction industry	22	39
5. Light industry	21	15
6. Foodstuffs production	38	50

Sources: March (2006 and 2007) surveys by IET

Wages is not a problem for Russian enterprises when employing immigrants: only 1% of enterprises considered wages expectations of newly arrived employees as overrated. In 2006 82% of the enterprises’ managers believed that local citizen’s and immigrant’s wages, their qualification being the same, should be equal.

The immigrants have better chances to become employed at a Russian industrial enterprise in construction materials industry (16% of responses “no obstacles”), timer and wood processing industry (14%) and light industry (11%). In machine-building only 2% of factories are ready to employ them.

S.V.Tsukhlo

Foreign Trade

The positive dynamics of export and import figures is sustained thanks to favorable situation at the world market and the increase of solvent internal demand. However the slow-down of the growth rates of Russian foreign trade turnover is observed due to the decrease in export value volumes.

It is planned to introduce export duty for corn in Russia.

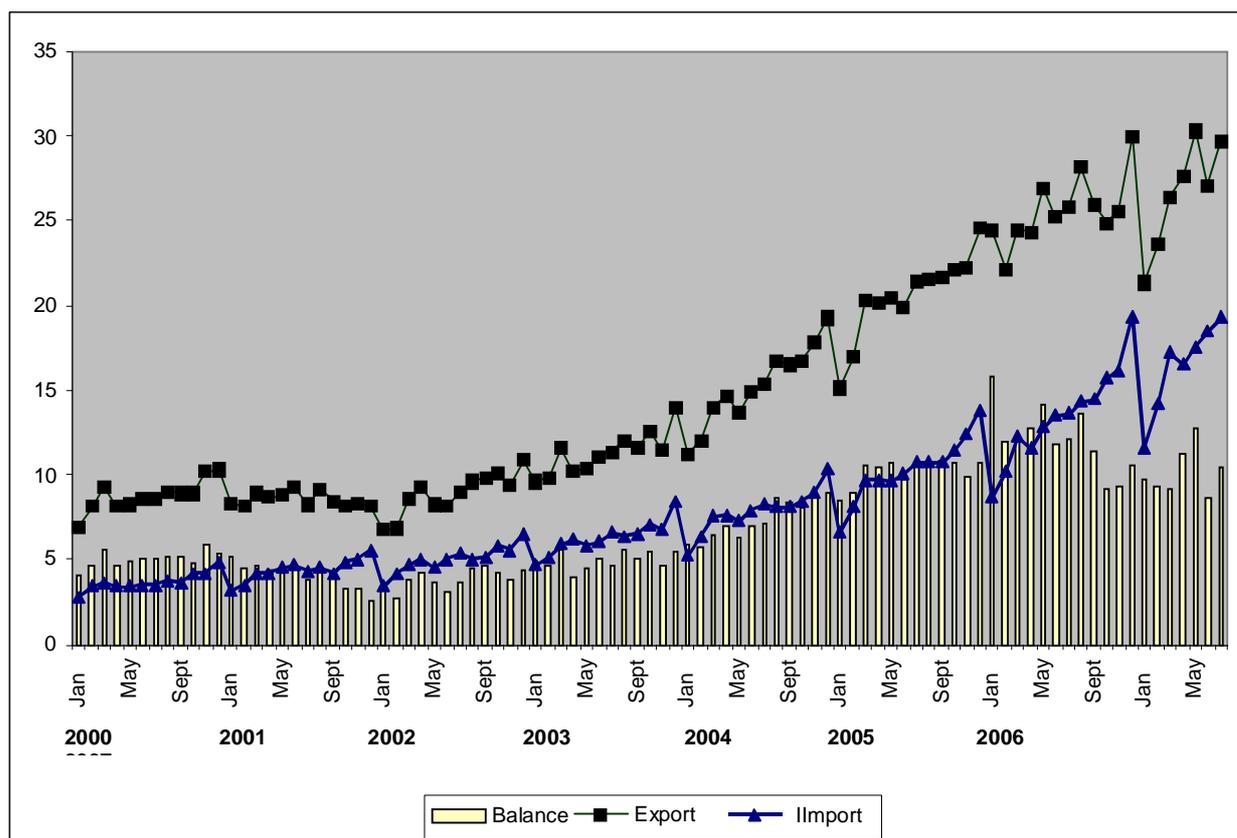
At the end of September a regular consultation round on Russia’s accession to the World Trade Organization took place in Geneva.

The trend which has been observed since the end of the last year – combination of quite moderate export growth and anticipating import growth – sustained in July 2007. Russian foreign trade turnover calculated by the balance-of-payments methodology increased by 14.9% in July 2007 as compared with July 2006 and was equal to USD 49.1 bln. The volume of Russian export reached 29.7 bln in July 2007, which is by 14.9% more than in July 2006. Export to non-CIS countries was equal to USD 25.05 bln, thus being by 13.7% higher than in July 2006, to CIS countries – USD 4.7 bln (growth by 24.1%). The volume of the im-

port to the Russian Federation reached USD 19.3 bln, being by 41% higher than in July 2006. It is notable that a significant growth of supplies was observed both from CIS and non-CIS countries. Import from non-CIS countries increased by 42% (USD 16.5 bln), and from CIS-countries – by 35.4% (USD 2.8 bln). In July 2007 Foreign trade balance of the Russian Federation was positive of USD 10.4 bln, having decreased by 14.6% as compared with the figures for July 2006.

Figure 1

Main Indices of Russian Foreign Trade as USD bln



Source: Central Bank of the Russian Federation

In July 2007 increase of export value volume accelerated a bit as compared with May and June figures but still remains behind the corresponding figures for the last year. It is the slowing down of world prices for oil growth rates, the reduction in export share in production volumes, real ruble exchange rate appreciation that accounted for export growth deceleration.

Nevertheless the situation at the world market in July 2007 was favorable for Russian exporters.

Due to the sharp decrease in oil stocks and remaining at the maximum level from the beginning of the year demand for petrol at the USA world prices for oil went up constantly. Besides the market was under the influence of experts' forecasts that world consumption of oil would grow in connection with continuing economic upsurge of the Asian developing countries, and China first of all.

In July 2007 the average world price for oil grade Urals was equal to USD 74.2 per barrel and increased by 9.3% as compared with June 2007 and by 7.4% as compared with July 2006. According to July-August monitoring average price was USD 71.61125 per barrel. Thus, the volume of export duty for crude oil will be increased by USD 26.4 from 1 October and will be equal to USD 250.3 per ton. In August-September 2007 the duty rate was equal to USD 223.9 per ton of crude oil. New duty rate will be of the record value so far. Last year export duty reached its maximum of USD 237.6 per ton. From 1 October duties for light oil products will increase from USD 163.2 to USD 181 per ton, for dark oil products – from USD 87.9 to USD 97.5 per ton. These figures are also record breaking.

Prices for Russian natural gas remained high. In July 2007 average monthly contract price for Russian natural gas for supplies to the Countries of the Western Europe remained approximately at the level of July of the last year.

In July fluctuation of prices for aluminum were not as significant as in previous months. Increasing stocks and production had a weakening effect on the market of aluminum.

Prices for copper after decrease in January-February went up in the months that followed, remaining at quite a high level.

At the end of July 2007 nickel prices went down to the level of USD 31155 per ton against USD 51650 per ton in May 2007. High growth of prices for that metal during January-May 2007 was stimulated by long-lasting shortage at the nickel world market. In summer exchange stocks of nickel increased significantly and reached the highest since June 2006 level, which was the reason for price drop.

All in all, over 7 months of 2007 world prices for nickel exceeded by 2.4 times, for copper –by 10.3%, for aluminum – by 9.5% average prices of the corresponding period of 2006.

Table

Average Monthly World Prices in July of the respective year

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Oil (Brent), USD/bbl	18.25	12.96	18.8	28.4	24.62	25.7	28.25	38.2	56.4	72.5	75.09
Natural gas, USD /1 mln BTU	2.121	1.983	2.363	4.01	3.15	2.94	5.021	6.034	7.554	6.305	6.539
Petroleum, USD /gallon	0.594	0.423	0.6	0.935	0.732	0.804	0.896	1.306	1.601	2.271	2.182
Copper, USD/ton	2481.7	1754.3	1744.8	1864.2	1541.4	1589.0	1730.3	2813.0	3614.0	7712	7962.7
Aluminum, USD/ton	1563.7	1377.7	1403.5	1565.9	1412.2	1338.4	1434.9	1710.0	1779.0	2513	2730.7
Nickel, USD/ton	6737.3	4620	5273	8202.0	5956.8	7143.1	8790.6	15038	14581	26585	33373

Source: calculated on the basis of London Metal Exchange (Great Britain, London), International Petroleum Exchange (London) data

Over January-July 2007 goods export from the Russian Federation increased by 10.1% as compared with January-July 2006 and was equal to USD 186.99 bln. The growth of export supplies was observed for nearly all groups of goods except fuel and power. The reduction of fuel and power export was mainly due to the decrease in natural gas export, which account for 19.7% in this group. Natural gas export decreased by 10.8% due to the reduction in terms of physical volume of 15.9%, despite the growth of contract prices. Crude oil and oil products export increased in terms of physical volume, correspondingly, by 4.4% and 3.1% export prices lowering but negligibly.

Export of foodstuffs and agriculture raw materials (except textile) to non-CIS countries increased significantly. In January-July 2007 it grew by more than 1.5 times as compared with the corresponding period of 2006, since the export of the most important commodity of this group – wheat and rye and wheat mix - more than doubled in terms of value, prices having increased by 55.4% and in terms of physical volume - by 30.1%.

Recently sharp growth of prices for wheat at the world market has been observed. In September 2007 all three American grain exchanges (Chicago, Kansas-city, Minneapolis) set new historic price records. December futures for soft wheat increased by USD 327.2 per ton in Chicago, for durum wheat – up to USD 315.62 per ton in Kansas-city, and for durum wheat in Minneapolis – up to USD 303.87 per ton.

It is expected that wheat crop in Russia this year will be a good one. According to the data of the Ministry for Agriculture of the Russian Federation grain of 76 mln of tons will be reaped. The shortage of grain over the world can however cause the sharp growth of export the consequence being the growth of prices for grain in the country. In July 2007 prices for grain in Russia reached record-breaking level, being RUR 6300 for the ton of 4-grade wheat and RUR 5700 for the ton of hard forage. This led to the increase of prices for bread, flour and other foodstuffs, wheat being the main raw material for them.

At the same time barley crop this year is poor and there is its shortage at the internal market, for forage purposes as well. In this connection export duties for wheat will be soon introduced in Russia. The rates of would-be export duty for barley have already been established, being 305 of the contract prices, but no less than 70 euro per ton.

By now the issue on possible limits for wheat export has also been considered. A number of details is being specified, concerning first of all the forecast of the situation at the world market and the dynamics of grain export from Russia. After introduction of limits for export the decision will be made to carry out goods grain sales. The optimal threshold for prices to make interventions was adjusted at the level of RUR 5000 per ton for 3-grade wheat.

The first sale of grain from the government investment fund at prices lower than market prices took place in February 2004. Within the half of the year the government sold then 1.54 tons of grain and so did not let

the prices to reach too high levels. Since then the government has already resorted to this mechanism several times to stabilize prices: not to allow them either falling too low or, on the contrary, rising too high.

Import into the Russian Federation increased by 37.4% over seven months of 2007 up to USD 114.9 bln. In July as well as in the first half year of 2007 import growth was accounted for mainly by growth of population's demand and high level of investment activity. Besides, import growth continued to be stimulated by the real ruble exchange rate appreciation.

In January-July 2007 among the most significant import goods it is passenger cars import - their share in the total amount of import was equal to 10.7% against 8.9% a year ago – ferrous metals, trucks, pipes, meat beverages and clothes import that increased considerably. Over that period over the main import goods medicines' import decreased.

Foreign trade turnover calculated on the basis of balance-of-payments methodology was equal to USD 301.9 bln in January-July 2007, exceeding by 19.1% the figure of January-July 2006 (USD 253.3 bln). Positive foreign trade balance of the Russian Federation in January-July 2007 was equal to USD 72.1 bln, being by 16.3% lower than in January-July 2006.

On 26 September 2007 a regular round of consultations concerning Russia's accession to the World Trade Organization (WTO) took place in Geneva. A number of issues of WTO agreement project were discussed, for instance those, concerning registration requirements for export operations, government purchase, duties, connected with service rendering. By the next round of consultations, which will occur last decade of October, Russian party should prepare a new project of agreement for the issues concerning phytosanitary regulations and technical bars for trade in compliance with the recommendations of working group.

On the same day bilateral consultations with Saudi Arabia, which was the last country, with which the protocol on negotiations conclusion had not been signed, took place. This round of consultations occurred as a consequence of Saudi Arabia's request, and it concerned a large number of issues, connected with goods and services accession to the markets and Russia's guarantees for that. It was decided, that the Saudi Arabia's request will be narrowed and will apply to the spheres in which Saudi's party are interested for the time being. The agreement was reached for the next round of negotiations, which will most probably take place in October, will be the last. Trade turnover between Russia and Saudi Arabia is comparatively small. In 2006 export from that country to Russia was equal only to USD 6 mln.

It was planned that at the end of September bilateral Russian-Georgian consultations on remaining disagreements concerning Russia's accession to the WTO will take place in Geneva. The Georgian party however suggested that a new round of negotiations be conducted at the beginning of October in Tbilisi.

N.Volovik

On the measures aimed at the improvement of the program of additional provision of medicines to the selected categories of citizens of the Russian Federation.

Financial problems encountered in the course of implementation of the program of additional provision of medicines to the selected categories of citizens of the Russian Federation (hereinafter referred to as APM) in 2006 resulted in the necessity to change this program. The measures aimed at the modernization of the program have been discussed by the operators of the program, representatives of the concerned agencies of the executive branch of the Russian Federation and a broad range of experts over the first six months of 2007. As a result, there were determined the major avenues of improvement of the APM program to be taken this and several next years.

An analysis of implementation of the APM program in the first six months of 2007.

According to the data presented by the RF Ministry of Health Care and Social Development, as on January 1, 2007, the payment arrears relating to supplied medicines made Rub. 24.8 billion.

Over the whole first six months of 2007 there continued the analysis of the results of the expert evaluation of supply of medicines in 2006 and the repayment of the existing payment arrears carried out by the territorial funds of compulsory medical insurance. The payment arrears could be repaid in full in 12 subjects of the Russian Federation: the Belgorod oblast, the Aginsk Buryat, Nenets, Komi Perm, Evenk, Koryak and Chukotka Autonomous Okrugs, the Republics of Ingushetia, Altai, Sakha (Yakutia), Mari El and the Chechen Republic. On the whole, in the Russian Federation the bulk of the payment arrears could be repaid over 2007.

In 2007, the aggregate amount of financial resources from the budget allocated for the payment for medicines should make about Rub. 58 billion, including Rub. 26.74 billion to be transferred in January through August of this year, what should improve the situation regarding the provision of medicines in the future.¹⁶

The share of prescriptions to be serviced after a delay has declined from 14 per cent to 1.15 per cent since the beginning of the year. The largest number of prescriptions to be serviced after a delay was registered in April of 2007 and made about 1.7 million of prescriptions; by now the number of such prescription has declined by 3 times, whereas the amount of supplied medicines made Rub. 30.25 billion what permitted to service 50.517 million prescriptions.

On the whole, in 2007 the situation concerning the provision of necessary medicines to the selected categories of the RF citizens was of a more stable nature.

At the same time, the measures aimed at the monitoring of the situation revealed some systemic flaws existing in the subjects of the Russian Federation as concerned the justification of prescription of medicines and the quality of planning with respect to the financing needs. A sociological survey carried out on commission of the RF Ministry of Health Care and Social Development revealed that one of the most serious problems faced by the recipients of the package of social services was long waiting times in the offices of the doctors prescribing medicines (40 per cent of the total number of respondents). In some subjects of the Russian Federation (the Orel, Ryazan, Sverdlovsk, Chelyabinsk, and Novosibirsk oblasts, in the Republics of Adygea, Kalmykia, Bashkiria, Udmurtia, in the city of St. Petersburg, in the Perm and Khabarovsk krais) the share of prescriptions to be serviced after a delay remained rather high.

Proposals concerning changes in the APM program implementation mechanisms.

In order to attain a stable level of provision of the RF citizens with the necessary medicines and taking into account the proposals advanced by the subjects of the Russian Federation the RF Government has developed some measures aimed at the improvement of provision of medicines, which should permit to combine the exercise of the powers vested in the subjects of the Russian Federation, improve the manageability of financial and merchandise flows and prescription of medicines. At the same time, there should be created a more strict system of control over the supply of, demand for and justification of prescription of necessary medicines to be provided to the selected categories of the RF citizens on the part of the regulatory and supervisory federal agencies:

1. Since 2008, the federal authorities should delegate to the subjects of the Russian Federation the powers permitting them to carry out auctions for state procurement of medicines necessary for the selected categories of the RF citizens as a part of the package of social services.

2. The citizens in need of the treatment of nosological entities requiring expensive therapy (hemophilia, cystic fibrosis, pituitary nanism, Gaucher's disease, myeloid leukemia, multiple sclerosis and so on) should be set as a separate group and provided necessary medicines notwithstanding the fact if such citizens have the established right for the state social assistance envisaged by federal law No. 178 FZ of July 17, 1999, "On the state social assistance."

In order to implement this program, item 5 of article 1 of federal law No. 132 FZ of July 17, 2007, "On the introduction of amendments to the federal law "On the federal budget for year 2007" envisages the allocation of financial resources from the federal budget to the Federal Agency of Health Care and Social Development for the centralized procurement of medicines in accordance with the list to be set forth by the Government of the Russian Federation.

3. There should be introduced the methods of standardization of medical care, what should permit to improve the predictability of expenditures for medical care, to optimize provision of medicines and ensure the guarantees of availability of high quality medical care for citizens of the Russian Federation. As on September of 2007, there were approved more than 500 standards, including the list of diagnostic and treatment procedures, as well as the necessary drug treatment of a concrete nosology.

An analysis of financing of the APM program at the expense of financial resources allocated from the federal budget in 2005 through 2008.

Table 1 presents the amounts of financial resources allocated for the financing of the APM program in 2005 through 2008.

The data presented in the Table permits to arrive at the conclusion that the financing of the APM program in 2005 through 2007 increased in absolute terms, at the same time, the number of citizens seeking to be

¹⁶ Draft Report of the RF Ministry of Health Care and Social Development "On the measures aimed at the improvement of provision of medicines."

provided medicines under the APM program declined from 14.8 million persons in 2005 to 7.9 million persons in 2006 and stabilized at approximately this level (7.75 million persons) in 2007. In 2008, it is planned to leave the level of financing of the program at a comparable level permitting to provide the citizens, who chose the right to receive medicines in stead of money compensation. The final calculation of the need for financing of the APM program in 2008 should be carried out after the registration of the number of citizens having the right to receive medicines as a part of their social services packages (SSP).

Table 1.

The amount of financial resources envisaged by the federal budget for funding of the APM program in 2005 through 2008.

Year	Amount of allocated financial resources		Total number of citizens having the right to receive medicines as a part of their SSPs
	Total	Including the following expenditures	
2005	Rub. 48.3 billion	Allocated for the implementation of the measures of social support of the selected categories of citizens as concerns the provision of necessary medicines (article 6 of federal law No. 165 FZ of December 20, 2004, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2005") ¹⁷	14.8 mil. persons
2006	Rub. 55.08 billion	Allocated for the implementation of the measures of social support of the selected categories of citizens as concerns the provision of necessary medicines (article 11 of federal law No. 171 FZ of December 22, 2005, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2006")	Rub. 29.08 billion
		Allocated for the finalization of payments for the medicines supplied in 2006 from the balance of allocations for the implementation of the measures of social support of the selected categories of citizens as concerns the provision of necessary medicines (article 8 of federal law No. 243 FZ of December 29, 2006, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2007")	Rub. 10 billion

¹⁷ Rub. 4.99 billion were allocated for the finalization of payments for the medicines supplied in 2005.

Year	Amount of allocated financial resources		Total number of citizens having the right to receive medicines as a part of their SSPs
	Total	Including the following expenditures	
		Allocated from the federal budget for the finalization of payments for the medicines supplied in 2006 from the subsidies for the implementation of measures envisaged in the framework of the base program of compulsory medical insurance (article 8 of federal law No. 243 FZ of December 29, 2006, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2007")	Rub. 6 billion
		Envisaged for allocation in order to finalize the payments for medicines supplied in 2006 from the budgetary allocations for the implementation of territorial programs of compulsory medical insurance in the framework of the base program of compulsory medical insurance (item 5 of article 1 of federal law No. 132 FZ of July 17, 2007, "On the federal budget for year 2007")	Up to Rub. 10 billion
2007	Rub. 58.43 billion	Allocated for the implementation of the measures of social support of the selected categories of citizens as concerns the provision of necessary medicines (article 5 of federal law No. 243 FZ of December 29, 2006, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2007")	Rub. 34.9 billion
		Envisaged for allocation from the federal budget in order to finalize the payments for medicines supplied in 2007 from the financial resources of the standard insurance reserves of the Federal Fund of Compulsory Medical Insurance and budgetary allocations (article 7 of federal law No. 184 FZ of July 21, 2007, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2008 and the planning period of years 2009 and 2010")	Rub. 15 billion
			7.748 mil. persons

Year	Amount of allocated financial resources		Total number of citizens having the right to receive medicines as a part of their SSPs
	Total	Including the following expenditures	
		Financial resources allocated for the finalization of payments for the medicines actually supplied to the selected categories of citizens in 2007 (article 13 of federal law No. 243 FZ of December 29, 2006, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2007")	Rub. 0.53 billion
		Financial resources envisaged for allocation from the standard insurance reserves of the Federal Fund of Compulsory Medical Insurance in order to finalize the payments for medicines actually supplied to the selected categories of citizens in 2007 (article 13 of federal law No. 243 FZ of December 29, 2006, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2007")	Up to Rub. 7.81 billion
		Allocated subsidies from the federal budget for the finalization of payments for the medicines supplied in 2007 from the balance of budgetary allocations for the implementation of measures of social support of the selected categories of citizens as concerns the provision of necessary medicines (article 7 of federal law No. 184 FZ of July 21, 2007, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2008 and the planning period of years 2009 and 2010")	Rub. 8 billion
		Envisaged for allocation from the financial resources of the standard insurance reserves of the Federal Fund of Compulsory Medical Insurance in order to finalize the payments for medicines actually supplied to the selected categories of citizens in 2007 (article 6 of federal law No. 184 FZ of July 21, 2007, "On the budget of the Federal Fund of Compulsory Medical Insurance for year 2008 and the planning period of years 2009 and 2010")	Up to Rub. 10.34 billion

Year	Amount of allocated financial resources		Total number of citizens having the right to receive medicines as a part of their SSPs
	Total	Including the following expenditures	
2008	Not determined yet ¹⁸	Transfer of financial resources from the Pension Fund of the Russian Federation to the Federal Fund of Compulsory Medical Insurance for the provision of state social assistance to the selected categories of citizens as concerns their provision with medicines should be carried out proceeding from the number of citizens retaining the right to receive the package of social services and financial expenditures per one citizen in the amount set forth by the Government of the Russian Federation.	Will be determined after October 1, 2007

M. Gladkov

Meetings of the Government of the Russian Federation in September 2007

In September 2007 at the meetings of the Government of the Russian Federation the following most important issues were discussed: on process of federal target programs execution and of federal targeted investment program fulfillment over the first half of 2007, the report “Federal Antimonopoly Service: results of 2006 and main directions of action for 2008-2010”, bill “On making amendments to the Federal Law “On securities market”.

On **5 September** at the meeting of the Government of the Russian Federation the issue on the process of federal target programs fulfillment and federal targeted investment program execution over the first half year of 2007 was discussed.

In the first half year of 2007 46 federal targeted programs and 36 subprograms, included in the public part of the federal budget, were being fulfilled. For reference, in the first half year of 2006 51 federal target programs and 50 subprograms were being executed.

In 2007 federal target programs execution is aimed primarily at the development of industrial and social infrastructure, innovation activity stimulation, support of regions, creation of conditions to increase human resources quality and country’s competitiveness.

In the report on federal target programs fulfillment over the first half year of 2007, analysis was carried out, taking into account the results achieved on program measures fulfillment, program’s aims attainment, targeted indices and efficiency figures, contract signing by government customers and the course of contracts’ execution, attraction of funds by government customers from the budgets of Russian Federation subjects, local budgets as well as off-budget resources to fulfill program’s measures.

Out of 46 programs analyzed government customers’ work on only 5 of them was recognized as effective, on 36 – satisfactory and on 5 – of low efficiency.

For a number of programs a lag was discovered in regard to contracts signing, attainment of planned figures for target indices and indicators envisaged for the accounting period. Financing of the federal programs

¹⁸ It is envisaged that for the period of years 2008 and 2009 Rub. 47.9 billion should be allocated as the targeted transfer of financial resources to the RF Ministry of Health Care and Social Development for the purchase of medicines designated for the treatment of persons suffering of hemophilia, cystic fibrosis, pituitary nanism, Gaucher’s disease, myeloid leukemia, multiple sclerosis and other illnesses requiring expensive therapy.

was not always executed to the extent established, this applies also the expenses of subjects of Russian Federation and off-budget sources.

Among main reasons prevented achievement of the planned results the following were marked: untimely contest for research and development execution conducting, work at construction sights and objects, tardy preparation of normative legal acts, securing fulfillment of the federal law "On federal budget for 2007", untimely signing of agreements with RF subjects and municipal formations on program measures co-financing, existence of limitations for financing of a number of construction sights and objects in connection with the absence of the papers required.

As a result of report discussion the Government of the Russian Federation made decision to postpone this issue consideration.

On *13 September* at the meeting of the Government of the Russian Federation the report "Federal Antimonopoly Service: results of 2006 and main directions of action for 2008-2010" was considered.

Reports on results and main directions of subjects of budget planning activity (RRMDA) are one of the elements of program-target planning in the operation of bodies of executive power. RRMDA conception made official with the adoption of the Conception of budget process reformation in the Russian Federation in 2004-2006. Principles and regulations for documents preparation and submission of the reports on results and main directions of subjects of budget planning activity, to which, according to the legislation currently in effect federal Antimonopoly Service belongs, are regulated by the Statement on the reports results and main directions of subjects of budget planning activity, adopted by the Decree of the Government of the Russian Federation from 22 May 2004 No 249 "On measures to increase effectiveness of budget expenditures".

In the RRMDA by Federal Antimonopoly Service information on a series of measures taken by the Service, in which it took part as a government body, pursuing the state policy in the field of control and supervision: Federal Antimonopoly Service of Russia actions aimed at fulfilling of the tasks, which solution is necessary to achieve priority targets of the Government of the Russian Federation, which are determined in the Combined Report of the Government of the Russian Federation for 2006-2008, analysis of the main indices of FAS effectiveness and other data are presented.

In general, the report of the Federal Antimonopoly Service was approved by the Government of the Russian Federation, and Federal Antimonopoly Service, Ministry for the Economic development and Trade, Ministry of Finance of the Russian Federation are charged with elaborating of the Report mentioned, paying special attention to:

- specifying the aims of Federal Antimonopoly Service action, in the part of publicity and transparency security for the procedures of order placement for goods supplies, work execution, service rendering for governmental and municipal needs, including for government defense order;
- correction of the targeted figures for the index, characterizing Federal Antimonopoly Service of the Russian Federation place in the international rating of competitive agencies efficiency, as well as Federal Antimonopoly Service indicators for control in the field of order placement for foods supply, work execution, service rendering for governmental and municipal needs;
- substantiation of the change in the figures for Federal Antimonopoly Service of Russia action, including those, concerning FAS resolutions cancelled by court on cases of monopoly action or unfair competition, decisions on inconsistency with the antimonopoly legislation of the decrees and acts of the government bodies and local government, repeated violations of antimonopoly legislation;
- giving more precise definition of the receipts from fines for antimonopoly legislation violation, advertising legislation and legislation on order placement.

On *20 September* at the meeting of the Government of the Russian Federation the project of the federal law "On making amendments to the Federal Law "On securities market" (in part of specification of the notifications on essential facts)" presented by the Federal Service on Financial Markets was considered.

According to the news release of the meeting the main idea of the bill consists in developing of legal conditions for revealing of the information on essential facts (events, actions) that concern financial and economic activity of the securities issuer. The aim of the bill is to specify the list of notifications on essential facts to be revealed by the securities issuers to all parties concerned regardless of the aims for which such information is obtained. The requirements for the issuers to reveal information on essential facts are established in order to minimize informational misbalance and to secure for the investors the possibility to react to the change of issuer's securities investment characteristics, connected with the dynamics of events happening to the issuer, changes in its financial and economic situation and other factors, which can influence the value of issuer's securities, on time. The revealing of the information in the form of notifications on essential facts, according to the idea of bill creators, enables the share holders to execute efficient control as to how

the company's management proceeds as well as to be well-informed on important decisions, concerning planning and realization of essential corporative actions of the issuer.

The bill suggest that the following events be included in the list of essential facts: decisions of the board of directors (supervisors' board) of the issuer, termination of authority of individual and (or) members of corporate executive bodied of the issuer, changes in the market share of the individuals, who are members of issuer's management bodies, initiation of proceedings on bankruptcy by the Supreme Arbitrary Court towards issuer and (or) its branches and dependent organizations, and (or) introduction of one of the bankruptcy procedures, receipt (recall) of licenses, which are substantial for issuer's actions.

The Government of the Russian Federation approved the bill and decided to submit it to the State Duma.

M. Goldin

Review of the Regulatory Documents Concerning Taxation Issued over August-September 2007

1. By the letter of the Ministry of Finance of the Russian Federation from 29 August 2007 No 03-03-06/1/606 it is clarified that in accordance with subparagraph 2 paragraph 7 clause 254 of the Tax Code the losses from shortage or damage during storage and transportation to the material and industrial stuff within the normal limits of natural loss are equated to material expenditures taken into account in process of profit taxation. Up to the present moment the Decree of the Government of the Russian Federation from 12.11.2002 N 814 "On the procedure of approval of normal limits of natural losses during storage or transportation of trade and material goods" has still been in effect. In compliance with the decree regulations are being elaborated by ministries and departments.

The procedure of settlement within the industry the problems of development and approval of regulations for technological losses during production and (or) transportation is not under the jurisdiction of tax and duties legislation. That's the reason why the new version of subparagraph 3 paragraph 7 clause 254 of the Tax Code of the Russian Federation that came into the effect since 1 January 2006. According to it, to tax profit technological losses during production and (or) transportation are equated to the material losses.

The Ministry of Finance of the Russian Federation elucidated that according to specific technological features of the production cycle itself and transportation process tax-payers can identify the regulations for formation of irretrievable losses for each specific kind of materials and raw materials that are used in the production. At a plant these regulations can be established, for example, by flow sheets, estimates of the technological process or other similar documents, which are internal documents of the enterprise and do not have a single form; they are developed by the enterprise's experts who control technological process (e.g. production engineers) and are approved by persons authorized by the enterprise's directorship (e.g. chief engineer or chief production engineer).

2. The letter of the Ministry of Finance of the Russian Federation from 4 September 2007 No 03-03-06/1/640 clarifies the issue of taking into account of organizations' expenditures for petrol in order to tax profit.

In particular, it is elucidated that the regulatory document of the Ministry of Transportation of the Russian Federation from 29.04.2003 (Guidance document P3112194-0366-03) establishes the norms for petrol and lubricants consumption for motor-vehicles. According to paragraph 2 of the General Statements of the Guidance document it is also established that the norms for fuel (lubricants) consumption are also intended to make payments of enterprises' taxation. This is the reason why, according to the opinion of the Ministry of Finance, it is necessary to take into account the Guidance mentioned for the purpose of fiscal accounting. Formal confirmation of the expenditures is sale check for fuel and waybills.

In regard to the vehicles for which the norms of fuel and lubricants consumption are not established, the tax-payer should take corresponding technical documentation and (or) information which is supplied by the vehicle manufacturer in order to determine the norms for fuel consumption.

3. The letter of the Ministry of Finance of the Russian Federation from 4 September 2007 No 03-03-06/1/641 the issue of taking into account the leave payments in the structure of organization's expenses in the process of determination of taxation base for profit tax. This concerns the employees whose holidays fall for two account periods. For instance, it is clarified that expenses for leaves are applied for the time of their charge, and not for the time of their real payments by cash or another form of their remuneration. So, in the process taxation base determination the sum of the of accrued holiday pay for annual paid leave is included in the structure of expenditures in proportion to the number of days, which fall for each account period.

4. The letter of the Ministry of Finance of the Russian Federation from 4 September 2007 No 03-03-06/1/639 the issue of taking into account the objects of standard building as main assets for instance all de-

VICES and accessories of personal computer standard fit (screen, system unit, uninterrupted power supply unit, keyboard) which comply the complex of structurally linked objects and are able to function only as a complex are to be included in the single inventory object.

5. The letter of the Ministry of Finance of the Russian Federation from 31 August 2007 No 03-03-06/1/628 clarifies the issue on the procedure of the civil contract signing by the financial rent (leasing) in order to apply special depreciation coefficient, no higher than 3 however while determining the taxation base for profit tax.

It is elucidated that since there are no special requirements approved in regard to the contract of financial rent (leasing) by the Tax Code of the Russian Federation, the contract of the financial rent (leasing) that is signed in compliance with the Civil Code of the Russian Federation is to serve as such for taxation purposes. At the same time paragraph 2 clause 15 of the Federal Law from 29.10.1998 No 164-ФЗ "On financial rent (leasing)" states that in order to fulfill its obligations according to the leasing contract leasing subjects sign compulsory and accompanying contracts. Thus, the compulsory condition to recognize financial rent (leasing) contract as valid is the sale contract, signed in accordance with paragraph 2 clause 15 of the Federal Law No 164-ФЗ.

6. The letter of the Federal Tax Service of the Russian Federation from 3 September 2007 No 10-1-03/3566 explains that up to 1 January 2008 the sums of excessively paid (levied) taxes, fees, duties and fines are subject to repayment (reckoning) at the expense of inpayment sums which are to be paid to the corresponding budget of the budgetary legislation of the Russian Federation. That's why in case the tax-payer has made an error in OKATO (Russian Classification of Objects of Administrative Division) or KBK (Budget classification code) while filling the form of payment order the recalculation of fees does not occur in 2007 since fees are the compensation for the budget losses due to untimely or partial payment of the charged sums.

7. The letter of the Federal Customs Service of the Russian Federation from 29 August 2007 No 01-06/32387 clarifies the procedure of tax exemption of value added tax in regard to pedigree cattle, which is supplied into the territory of the Russian Federation within the framework of leasing contracts. The privilege will be in force up to 31.12.2008. VAT exemption can be granted on submitting the documents that testify the observance of criteria of organization ascription to agriculture producers, which are envisaged by paragraph 2 clause 346.2 part two of the Tax Code. Notification of the possibility on application of tax system for agriculture goods producers, which is issued by the taxation body by the place of organization's location can serve as such a document. The form of such a notification was approved by the Order of the Ministry of Taxes and Duties of the Russian Federation from 28.01.2004 No БГ-3-22/58.

L. Anisimova

Review of the Budgetary Legislation over September 2007

The following innovations were made to the budgetary legislation in September 2007:

- The Decree of the President of the Russian Federation transfers the function of Investment Fund capital management aimed at granting government support, which was previously implemented by the Ministry for Trade and Economic Development, to the Ministry of Regional Development;
- The Decree of the Government of the Russian Federation establishes new regulations for Federal property registration;
- The Order of the Ministry of Finance ratifies the procedure for striking off the books and taking on the books again the debts of the monetary liabilities to the federal budget;
- The Orders of the Ministry of Industry and Energy approves the algorithm to calculate the amount of funds allocated to federal budgets in the form of grants to liquidate interregional cross-funding in power industry as well as the regulations for grants rendering from the federal budget to the federal government enterprises by the Federal Agency on Industry in 2007;
- The Order of the Ministry of Transportation confirms the procedure for book-keeping on purposeful use of grants, allocated from the federal budget to the regional budgets to give grants to urban (urban-type villages') budgets for the development of streets network.

Decrees of the President of the Russian Federation and the Government of the Russian Federation

Decree of the President of the Russian Federation from 24.09.2007 No 1274 "Issues of the federal bodies of executive power structure".

The Decree establishes new structure of the federal bodies of executive power. Among the changes, concerning the system and structure of the federal bodies of executive power, the following is to be noted. The

function of Investment fund capital management aimed at granting government support, which was previously implemented by the Ministry for Trade and Economic Development, is transferred to the Ministry of Regional Development.

Decree of the Government of the Russian Federation from 16.07.2007 № 447 “On making improvements to federal property registration”.

The Decree ratifies the Statute on federal property registration. The Statute determines the procedure for federal property registration and for submission of the information from the register to the bodies of the government, including RF Constitutional Court, RF Supreme Arbitral Court as well as to Procurator-General’s Office and RF Clearing House, Plenipotentiary of the RF President in the federal okrugs, regional bodies of the federal bodies of executive power, government institutions of the subjects of the Russian Federation, courts, law-enforcement institutions, institutions, implementing government registration of the rights for immovable property and deals with it, local government bodies and rightholders not oftener than once a year (only with the regard to the federal property that they own). The decree also provides definition of the federal property registration object. The Federal Agency of Federal Property Management is entrusted with the duties to record federal property and keeping register of the federal property.

The Decree does not apply to the record of the federal property in the part of inclusion of the data, which are referred in the procedure approved to the government secret, to the register.

Besides, the Decree of the Government of the Russian Federation from 16 July 2007 No 447 recognizes the Decree of the Government of the Russian Federation from 03.07.1998 No 696 “On organization of the federal property register and record-keeping of the federal property” as invalid.

Legal Acts of the Federal Bodies of Executive Power

The Order of the Ministry of Finance of the Russian Federation from 02.08.2007 No 68H “On approval of the procedure for striking off the books and taking on the books again the debts of the monetary liabilities to the federal budget (Russian Federation)”. It was registered in the Ministry of Justice of the Russian Federation from 28.08.2007 No 10062.

The Procedure establishes rules and conditions for striking off the books and taking on the books again the debts of the monetary liabilities of the subjects of the Russian Federation, municipal formations and legal entities to the federal budget (Russian Federation) in case of liability suspension (or recognition of the request by the liability as paid) on the grounds, ratified by the legislation of the Russian Federation or the court decision on recognizing liability as invalid or fulfilled that came into the legal effect.

The procedure is applied to the debtors’ arrears by the liabilities, which have arisen:

1. out of contracts and other deals;
2. out of court decision;
3. as a result of harm caused;
4. as a consequence of unfounded enrichment;
5. on other grounds, in accordance with the law or other legal acts, giving rise to civil rights and responsibilities.

The operation of the Procedure does not apply to liabilities on tax, fees, duties and fines payments, established by the tax and duties legislation as well as customs legislation of the Russian Federation.

The Law of the Ministry of Industry and Energy of the Russian Federation from 10.08.2007 No 315 “On approval of the procedure for calculation of the amount of funds allocated to federal budgets in the form of grants to liquidate interregional cross-funding in power industry directed to the organizations that are their recipients”. It was registered in the Ministry of Justice of the Russian Federation from 23.08.2007 No 10048.

The Procedure approved defines, in accordance with the Decree of the Government of the Russian Federation from 23.07.2007 No 465 “On giving grants to the budgets of the subjects of the Russian federation to liquidate interregional cross-funding in power industry”, the algorithm to calculate the amount of funds allocated to federal budgets in the form of grants to liquidate interregional cross-funding in power industry and directed from the budgets of the subjects of the Russian Federation to organizations that are their recipients.

The Order of the Ministry of Industry and Energy of the Russian Federation from 17.08.2007 No 318 “On approval of the regulations for grants rendering from the federal budget to the federal government enterprises by the Federal Agency on Industry in 2007”. It was registered in the Ministry of Justice of the Russian Federation from 14.09.2007 № 10137.

In order to fulfill the statement of the Decree of the Russian Federation from 23 February 2007 No 126 “On measures to fulfill the Federal Law “On Federal Budget in 2007” and in order to use budget funds efficiently the order establishes the procedure for grants rendering from the federal budget to the federal government enterprises in 2007 for purposeful expenses as a result of economic activities over the previous fi-

nancial year, connected with enterprises' operation as well as expenses for enterprises creation including by the way of restructuring. The Federal Agency on Industry acts at that as a chief manager of the funds.

It should be noted that in the clause 40 of the Decree mentioned above federal budget funds, envisaged by the chief manager in accordance with combined revenue and expenditure in the form of subsidies and subventions, can be granted only in compliance with the rules, established by the corresponding body, which governs the Russian Federation, or by a federal body of executive power, which functions as a standard legal regulation in the established sphere of action by making transfers of the funds to settlement accounts, set up by the recipient of the subsidies and subventions in credit institutions. The mentioned Regulations of subsidies and subventions granting are at that to be approved according to the procedure established in the 1 quarter 2007, which means that the Order of the Ministry of Industry and Power Industry of the Russian Federation being commented was approved with a considerable delay. As it is demonstrated by practice, such delays have a negative effect on the schedule of federal budget execution.

The Order of the Ministry of Transportation of the Russian Federation from 16.08.2007 No 123 "On introduction of book-keeping on purposeful use of grants, allocated from the federal budget to the regional budgets to give grants to urban (urban-type villages') budgets for the development of streets network". It was registered in the Ministry of Justice of the Russian Federation from 29.08.2007 No 10073.

In accordance with the Federal Law from 19.12.2006 No 238-ФЗ "On the federal budget for 2007" the Order establishes the form and the Procedure for compilation and submission to the executive power bodies of the subjects of the Russian Federation of book-keeping on purposeful use of grants, allocated from the federal budget to the regional budgets to give grants to urban (urban-type villages') budgets for the development of streets network.

M. Goldin

An analysis of normative legal acts regulating the procedures governing the creation and functioning of the Russian Corporation of Nanotechnologies and support of the nanotech industry

Over the past quarter there has been registered a large number of changes in the fiscal sphere. In particular, of a special interest there is the development of the innovation related legal and regulatory framework, including the laws and regulations concerning the sphere of nanotechnologies. Thus, it should be noted that in June of 2007 there was adopted federal law No. 139 FZ of July 19, 2007, "On the Russian Corporation of Nanotechnologies."

In order to assess the role played by this innovation in the system of measures aimed at the state support of the innovation sphere, first, this system should be analyzed as a whole. At present, the state support of the innovation sphere is carried out in the following ways:

- Provision of funding to the subjects of innovative activities via the system of federal targeted programs (primarily for the organizations belonging to the public sector);¹⁹
- Provision of funding via the system of specialized funds, such as the Russian Fund for Technological Development (RFTD) and the Fund of Development Assistance for Small Enterprises in the Sphere of Science and Technology (Assistance Fund). Both these Funds extend cheap loans to the subjects of innovative activities (RFTD extends interest free credits, whereas the Assistance Fund grants credits at the half discount rate of the RF Central Bank);
- Creation of special economic zones, technological parks, business incubators, innovation and technological centers, centers for technology transfer and so on;
- Creation of financial companies and venture funds;
- Creation of scientific and technological information centers (including scientific and technological libraries, for instance, the library at the Russian Academy of Sciences and so on).

¹⁹ Among the federal targeted programs (FTP) concerning the issues of support of innovative activities there may be also noted the scientific and technological program "Research and development along the priority avenues of development of science and technology for years 2002 through 2006" approved by Resolution of the RF Government No. 605 of August 21, 2001; the program "Integration of science and higher education of Russia for years 2002 through 2006" approved by Resolution of the RF Government No. 660 of September 5, 2001; the program "The national technological base for years 2002 through 2006" approved by Resolution of the RF Government No. 779 of November 8, 2001, and some others.

Active attempts to create a unified system of state support of the sphere of innovations has been made since 2005, when there was enacted federal law No. 116 FZ of July 22, 2005, "On special economic zones in the Russian Federation." Over this time there has been established a whole number of technical and promotional SEZs, as well as about 58 technological parks, 63 innovation and technological centers and about 100 centers for technology transfer.²⁰

Therefore, the establishment of the Russian Corporation of Nanotechnologies may be seen as one of the final stages of the formation of the system of state support of the sphere of innovation. As it has been already noted above, the procedures governing the functioning of the Russian Corporation of Nanotechnologies are determined by federal law No. 139 FZ of July 19, 2007, "On the Russian Corporation of Nanotechnologies."

In the same quarter of this year, there were also adopted:

- Resolution of the Chief State Sanitary Officer, Head of the Federal Service for Surveillance in Consumer Rights Protection and Human Welfare of the Russian Federation No. 54 of July 23, 2007, "On the surveillance of products manufactured with the use of nanotechnologies and containing nano-materials"
- Resolution of the RF Government No. 1188 r of August 25, 2006, "On the program of coordination of works in the sphere of nanotechnologies and nano-materials in the Russian Federation"
- Resolution of the RF Government No. 1175 r of September 7, 2007, "On the personal composition of the supervisory board of the state corporation "Russian Corporation of Nanotechnologies"
- Resolution of the RF Government No. 498 of August 2, 2007, "Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010" and other regulatory acts concerning the issues related to the support of the sphere of nanotech industry and the procedures governing the functioning of the Russian Corporation of Nanotechnologies.

The Russian Corporation of Nanotechnologies has been established with the aim of assistance to the implementation of the state policy in the sphere of nanotechnologies, development of the innovation infrastructure in the sphere of nanotechnologies, implementation of projects concerning the creation of promising nanotechnologies and nanotech industry. In order to attain the goals of its activities, the Corporation was granted the following rights:

- 1) to analyze projects in the sphere of nanotechnologies in order to make decisions on the subsequent financial backing of such projects at the expense of the Corporation's financial resources;
- 2) to carry out organizational and financial support of research and development in the sphere of nanotechnologies;
- 3) to carry out financing of projects in the sphere of nanotechnologies envisaging introduction of nanotechnologies or manufacturing of products in the sphere of nanotechnologies;
- 4) to carry out financing of projects aimed at the training of specialists in the sphere of nanotechnologies;
- 5) to carry out monitoring of the implementation of projects in the sphere of nanotechnologies financed at the expense of financial resources of the Russian Corporation of Nanotechnologies, as well as to exercise other functions envisaged by federal laws and other regulatory and legal acts of the Russian Federation.

The Russian Corporation of Nanotechnologies should provide financial backing for scientific projects implemented in the sphere of nanotechnologies. In particular, the financial resources being at the disposal of the Corporation should be allocated for the funding of:

- 1) research and development in the sphere of nanotechnologies carried out on the paid or free basis;
- 2) projects aimed at the introduction of nanotechnologies or manufacturing of products in the sphere of nanotech in the form of participation in authorized capitals of legal entities, in unit investment funds investing their financial resources in projects in the sphere of nanotechnologies, in not for profit organizations created for the purposes of development of nanotechnologies, or in the form of provision of financial resources on paid basis envisaging the repayment of such financial resources in the due time;
- 3) projects aimed at the training of specialists in the sphere of nanotechnologies, including such a way as assignment of financial resources on the free and non-refundable basis.

The Russian Corporation of Nanotechnologies has the following structure of managing bodies and control mechanisms. In the structure of the Corporation there are created: the supervisory board being its supreme managing body, as well as the scientific and technical council and the board of auditors.

The supervisory board of the Corporation consists of 14 members and the chief executive officer of the Corporation, who is a member of the supervisory board by virtue of his or her position. The members of the

²⁰ This survey is based on the statistical data made public in the course of the presentation made by G. V. Shepelev, a Deputy Head of the Directorate for Innovation Based Development and Infrastructure.

supervisory board of the Russian Corporation of Nanotechnologies should be appointed by the Government of the Russian Federation under the following procedure:

- 1) five members of the supervisory board should be appointed after nomination on the part of the President of the Russian Federation;
- 2) two members of the supervisory board should be appointed after nomination on the part of the State Duma of the Federal Assembly of the Russian Federation;
- 3) two members of the supervisory board should be appointed after nomination on the part of the Federal Council of the Federal Assembly of the Russian Federation;
- 4) five members of the supervisory board should be appointed after nomination on the part of the Government of the Russian Federation.

Assets of the Russian Corporation of Nanotechnologies should be formed at the expense of the contribution of assets by the Russian Federation; proceeds derived from the activities carried out by the Corporation, voluntary asset contributions and donations, as well as other lawful revenues and should be in the property of the Corporation. In particular, the law establishes that the Russian Corporation of Nanotechnologies should have the right to establish special purpose funds (i. e. create capital in order to attain the goals of its activities under the procedures envisaged by federal law No. 275 FZ of December 30, 2006, "On the procedures governing the formation and use of specific capital of not for profit organizations"). In the process of establishment of the Russian Corporation of Nanotechnologies it was planned to allocate for the development of this sphere Rub. 130 billion from the federal budget.²¹

It should be noted that the Russian Corporation of Nanotechnologies has been granted a large package of powers and is highly independent as concerns the settlement of current issues, including those relating to the investment of the financial resources being at its disposal. In particular, the law contains the provisions permitting to assert that the Russian Corporation of Nanotechnologies has the right to carry out business activities. Thus, article 5 of the law specifies that the assets belonging to the Corporation "should be formed at the expense of the contribution of assets by the Russian Federation; *proceeds derived from the activities carried out by the Corporation*, voluntary asset contributions and donations, as well as other lawful revenues and should be in the property of the Corporation."

Besides, in order to attain the goals envisaged by the law on the establishment of the Russian Corporation of Nanotechnologies, the Corporation has been granted the right to create other not for profit organizations at the expense of its assets and joint associations and unions on the conditions set forth by the decisions taken by the supervisory board of the Corporation. As concerns not for profit organizations, their rights to engage in business activities also remain practically unlimited by the regulations and laws currently in force.

The issues related to the procedures, terms and amounts of financing pertaining to nanotechnologies have been also reflected in the federal targeted program "Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010" adopted in August of 2007.²²

The said program envisages that more than Rub. 27.7 billion should be allocated for the support of the nanotech sphere. Thus, only in the budget for year 2008 and the planning period of 2009 and 2010 it is envisaged to allocate more than Rub. 9.5 billion for the development of the program "Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010."

At the same time, the authors of the program expect that by year 2015 the amount of sales of the products manufactured by the Russian nanotech industry should make from Rub. 250 billion to Rub. 300 billion, whereas the amount of proceeds relating to exports of nanotech industry products should reach from Rub. 70 billion to Rub. 75 billion.

Among the state clients of the program there were indicated the Federal Agency of Science and Innovation, the Federal Agency for Education, the Federal Agency for Atomic Energy, the Federal Agency for Space, the Federal Agency for Industry, the Federal Agency for Technical Regulation and Metrology and the Federal Service for Technical and Export Control. At the same time, the Ministry of Education of the Russian Federation is designated to play the role of the ordering customer and coordinator of the federal targeted program "Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010."

It should be noted that the Russian Corporation of Nanotechnologies has not been indicated among the recipients of budgetary financial resources under this targeted program and exactly the bodies mentioned above, as well as certain scientific institutions, are the recipients of the said funds. Therefore, the federal

²¹ For instance, this fact is referred to by the authors of the program "Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010."

²² See Resolution of the Government of the Russian Federation No. 498 of August 2, 2007.

targeted program under review should be seen as a parallel mechanism of support of the nanotech sphere along with financing of this sphere from the financial resources of the Russian Corporation of Nanotechnologies, whereas the RF Ministry of Education and Science, together with the Corporation, should be responsible for the attainment of the goals set forth by the program “Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010.”

The main goal of the program “Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010” is the “creation of a modern infrastructure of national nanotech network aimed at the development and realization of the potential of the domestic nanotech industry in the Russian Federation.” Taking into account this target, there were formulated the principal aims and expected outcomes, among which there were indicated the following:

Creation of the new generation of nano-materials and nanotechnologies to be used in the key areas of science and technology, resource and energy saving, industrial production, health care and production of food products, as well as to maintain the necessary level of national defense and security capabilities;

Increase in the share of products manufactured with the help of the nanotech industry created in the framework of the program “Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010” up to 75 per cent of the total amount of products of the nanotech industry manufactured in the Russian Federation; ensuring of the international standards as concerns research and development, provision of research and development, metrological, and technological equipment to the organizations engaged in the sphere of nanotech industry and obtaining of not less than 80 patents (including international patents) a year by the organizations participating in the program “Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010”;

Development and realization of the potential of the domestic nanotech industry and an active participation of the Russian Federation in the international scientific and technological cooperation; creation of a system permitting to record and keep information on the results of scientific research and technological development in the sphere of nanotech obtained by organizations of different organizational and legal forms, ensuring of access to such information; improvement of the methodological base of scientific, technological and innovative activities in the sphere of nanotech industry;

Creation of and provision of resources for unique scientific facilities, a network of centers for collective use of unique scientific and testing equipment; creation and development of innovation infrastructure, improvement of the mechanisms of cooperation among the participants of the innovation processes, including the organization of cooperation among scientific organizations, higher education establishments and industrial organizations with the view of introduction of new nanotechnologies and nano-materials in industrial production;

Maintenance and development of the human resources, including the creation of conditions for attraction and retention of talented young people in the sphere of nanotechnologies, return of leading Russian scientists and specialists in the sphere of nanotechnologies working at present abroad and assistance in employment thereof in the Russian Federation. At the same time, the share of research specialists with no less than 3 years of experience in carrying out research and development of technologies with the use of scientific equipment answering international level standards in the total number of research specialists of the organizations included in the national nanotech network should make no less than 70 per cent.

As yet, it is too early to assess the level of efficiency of the activities carried out by the Russian Corporation of Nanotechnologies, as well as the level of possible productivity of the program “Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010.”

However, it should be noted that granting of so broad powers concerning the sphere of expenditure of budgetary financial resources, including the possibility to invest the said resources in commercial projects and establish legal entities, to any single organization entails certain risks. Thus, it should be noted, for comparison purposes, that in order to settle the issues pertaining to investment of the funded component of the pension savings there was adopted a special federal law, which in detail stipulated the procedures, under which the said financial resources should be invested. As concerns the financial resources transferred to the Russian Corporation of Nanotechnologies, which it should have the right to use, no such detailed procedure has been set in place. At the same time, the powers of the Corporation pertaining to the disposal of the said financial resources are much more broad than the powers to use the funded component of pensions vested in the RF Pension Fund.

It should be also noted that at present in the sphere of innovation there is observed yet another serious, although somewhat unexpected problem, i. e. the lack of ready (well developed and containing detailed business plans) projects relating to the development of high technologies. For instance, the Russian Venture Company (RVC) has failed to use the financial resources transferred at its disposal in full. It can not be ex-

cluded that it also will be difficult to invest the financial resources provided for the development of the nanotech industry taking into account their targeted nature.

It is also not absolutely clear to what extent the authors of the program “Development of the infrastructure of the nanotech industry in the Russian Federation for years 2008 through 2010” have researched the potential target market of sales of high-tech products to be manufactured at the expense of the financial resources provided from the budget. The previous experience of commercialization of the products developed by Russian scientific organizations has demonstrated that the problem of sale of finished products is as a rule rather acute, whereas the respective markets turn out to be too small and not sufficiently developed.²³

A. Kireyeva

²³ For instance, this fact is indicated by certain data made public in the course of the presentation made by G. V. Shepelev, a Deputy Head of the Directorate for Innovation Based Development and Infrastructure.